PROPOSED CHANGES TO BOTH THE WORLD BANK-INTERNATIONAL DEVELOPMENT ASSOCIATION AND THE NORTH AMERICAN DEVELOPMENT BANK

HEARING

BEFORE THE

SUBCOMMITTEE ON
INTERNATIONAL MONETARY POLICY AND TRADE

OF THE

COMMITTEE ON FINANCIAL SERVICES

U.S. HOUSE OF REPRESENTATIVES

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PROPOSED CHANGES TO BOTH THE WORLD BANK-INTERNATIONAL DEVELOPMENT ASSOCIATION AND THE NORTH AMERICAN DEVELOPMENT BANK

THURSDAY, MAY 2, 2002

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON INTERNATIONAL MONETARY POLICY AND TRADE,
COMMITTEE ON FINANCIAL SERVICES,
Washington, DC.

The subcommittee met, pursuant to call, at 10:00 a.m., in room 2128, Rayburn House Office Building, Hon. Doug Bereuter, [chairman of the subcommittee], presiding.

Present: Chairman Bereuter; Representatives Ose, Capito, Sanders, Frank, Watt, Carson, Sherman, Bentsen, Hinojosa, and Gonzalez.

Mr. OSE. I want to call this hearing of the Subcommittee on International Monetary Policy and Trade to order. I recognize a quorum for today's hearing.

Today's hearing is designed to bring before the subcommittee two proposals. The first is to make more international assistance in the form of grants, rather than loans, and the second is the proposed changes to the Charter of the North American Development Bank.

President Bush has taken the lead recently in pushing for greater support of developing nations, and especially with working with our neighbor in Mexico. It is therefore proper that we should hear from today's two panels of witnesses on these proposals.

This subcommittee will soon address the role of the United States in the International Development Bank. Today, we will hear from Director Joseph Christoff, from the GAO's International Affairs and Trade Section. His staff has recently completed a study on this issue of grants versus loans in the President's proposal.

We also looked at the recent Monterrey conference, and the discussions between President Bush and President Fox on improved cooperation and the work of the North American Development Bank.

Today, four witnesses will address the subcommittee on this issue, bring a diverse set of viewpoints. Local leaders and businesses will give their perspective, while a former North American Development Bank Director will provide an insider's view.

I look forward to learning more on these issues and hearing from these witnesses, as the subcommittee prepares to address these issues. Mr. Bentsen, if you have an opening statement, I will recognize you for that purpose.

[The prepared statement of Hon. Doug Bereuter can be found on page 48 in the appendix.]

Mr. BENTSEN. Thank you, Mr. Chairman, and I appreciate that the subcommittee has called this hearing today. I do not have a statement, other than I do want to welcome what appears to be at least three Texans, who will testify on the second panel.

I do not know if Mr. Gonzales is from Texas or not, although I know Mr. Strada is from Texas, and we are glad to have these panelists. I believe our colleague, Mr. Gonzales, and I think Mr. Hinojosa, will also be here shortly.

So I yield back to you, Mr. Chairman.

Mr. OSE. I thank the gentleman.

Without objection, all Members may submit a written statement for the record. There being no other Members who wish to be recognized for opening statements, we will move to our first panel.

I want to introduce Mr. Joseph Christoff, who is the Director of the GAO's International Affairs and Trade team. Among the various areas under his direction is that of multi-lateral financial institutions.

Since Mr. Christoff joined the GAO in 1980, he has worked in offices in Washington, Chicago, and Frankfort, Germany. He received a Master's Degree in Public Administration from American University, and a Bachelor's Degree in Public Policy from Miami University of Ohio.

Welcome, Mr. Christoff; we have received your written statement for the record, and it has been reviewed and read. We would like to recognize you for 5 minutes, and then we will go to questions.

STATEMENT OF HON. JOSEPH A. CHRISTOFF, DIRECTOR OF INTERNATIONAL AFFAIRS AND TRADE, GENERAL ACCOUNTING OFFICE; ACCOMPANIED BY: THOMAS MELITO, ASSISTANT DIRECTOR

Mr. CHRISTOFF. Thank you, sir.

Let me first introduce my colleague sitting to my right, Mr. Tom Melito. He is my Assistant Director that is responsible for the work upon which my testimony is based.

I am very pleased to be here to discuss the impact that switching some loan to grants would have on poor countries' debt burdens.

Last year, President Bush proposed that the World Bank replace 50 percent of future loans with grants. As discussed in our recent report, we found that the Administration's proposal would help poor countries reduce their debt burdens, and would cost the World Bank $15.6 billion in present value terms. We also found that the proposal could be financed through small increases in donor contributions.

I would first like to provide some background on this issue, and then describe in more detail the results of our work.

During the 1970s and the 1980s, many poor countries borrowed heavily because the prices of their primary commodities were high, and they were optimistic that economic growth would remain strong.

By the end of 1997, 42 heavily indebted poor countries had accumulated over $200 billion in external debt. This debt was owed to multi-lateral institutions and bi-lateral donors. Much of this debt was not being repaid, or was repaid only with the support of donors.

In 1996, the heavily indebted poor countries initiative, known as HIPC, was created to provide debt relief to these countries.

According to the World Bank and the IMF, countries that receive debt relief under the HIPC initiation are projected to be debt sustainable within the next 20 years.

However, our work has found that this not likely to happen, because the Bank and the IMF assume that these countries' exports will grow at rates more than double their historical levels.

In reviewing debt burdens for 10 poor countries, we found that two key factors will make it difficult to achieve such high export growth rates. First, most of the 10 countries we analyzed are not likely to realize greatly increased export earnings, because they rely on agricultural or mineral commodities, whose prices have come down in recent years.

Second, productivity in many of these countries is expected to decline, as the result of HIV/AIDS. This disease is particularly problematic for the agricultural and mining sectors on which many of these countries depend.

Now how would the Administration's proposal help these poor countries. The Administration asserts that replacing 50 percent of future loans with grants would lesson poor countries debt burdens and increase their ability to repay future debt.

Our analysis confirmed this. We found that four of the ten countries we analyzed would be debt sustainable for 20 years. That is, they would have a debt-to-export ratio near or below the World Bank's 150 percent target, and two additional countries would be debt sustainable for most of that period.

More importantly, a shift from loans to grants would benefit all countries' ability to repay their future debt. If grants were to replace half of future loans, the average debt-to-export ratio of the 10 countries we analyzed would decline significantly, from about 430 percent to 235 percent.

We also found that providing poor countries with grants will help them more in the long term than forgiving 100 percent of their old debt. If all old debt were forgiven, the average debt-to-export ratio would only decline from about 430 percent to 400 percent.

While the debt forgiveness plan provides poor countries with a one-time benefit, its advantage is eliminated after 7 years, because these countries accumulate new debt that quickly becomes unsustainable.

Now let me briefly discuss the financing of the 50 percent grants proposal. The World Bank estimates that its financial loss in nominal terms would be $100 billion over 40 years. However, the Bank's methodology assumes that the value of a dollar received today is the same as a dollar received 40 years from now.

This assumption does not properly account for inflation and the investment income that would accrue over time. We made these adjustments and found that the present value of the Bank's loss would be $15.6 billion.

We also found that the World Bank could fully finance the grant's proposal if donors increased their contributions by 1.6 percent a year. This increase would be less than the expected rated of inflation, which is projected to be 2.3 percent over the next 40 years.

Donor contributions over the next 3 years are expected to grow about 4.4 percent each year, with U.S. contributions growing about 6 percent a year.

So in summary, Mr. Chairman and Members of the subcommittee, the 50 percent grants proposal would lessen the long-term debt burdens of poor countries, and could be financed through small increases in donor contributions.

That concludes my statement, and I would be happy to answer any of your questions.

[The prepared statement of Hon. Joseph A. Christoff can be found on page 85 in the appendix.]

Mr. OSE. Thank you, Mr. Christoff.

Mr. Melito, would you care to add anything?

Mr. MELITO. No, thank you.

Mr. OSE. We will go to questions now. I want to welcome the other Members who have joined us.

Mr. Christoff, you take us through the analysis of the difference in the World Bank estimate of cost, as opposed to GAO's present value estimate. How does the Administration propose to cover the $15.6 billion cost.

Mr. CHRISTOFF. Last week, at least in testimony before the House Appropriations Committee, Secretary O'Neill did agree, first of all, that a donor increase of 1.6 percent a year was the right estimate, in terms of how one could cover the cost of this proposal. Beyond that, I am not certain what the specifics of the Administration's proposal are, at this point.

Mr. OSE. So a 1.6 percent increase per year from the donor community would cover the $15.6 billion? That was what the testimony was.

Mr. CHRISTOFF. That is correct.

Mr. OSE. Are there any other viable options besides the 1.6 percent increase that were put on the table?

Mr. CHRISTOFF. Well, in our report, we did look at some other options that I think we did not consider to be too viable.

The World Bank, basically has to rely on donors. It has to rely on repayments from the poor countries. It also has to tap into its own internal resources. We did not see much viability in the World Bank trying to tap into its own resources; and one would not expect to try to place the burden of this proposal on the poor countries who are the beneficiaries. So that leaves you with increased donor contributions.

Mr. OSE. All right, now there are some who would argue that the reserves at the World Bank, and some would use the word "excessive," are excessive, and that they should be able to fund further debt forgiveness, or grant proposals such as this, from existing funds, without this 1.6 percent surcharge, so to speak, for the donor countries.

If that is true, or I guess I should say, is this true, in your opinion?

Mr. CHRISTOFF. The World Bank, at least at this point from our understanding, is even having difficulties trying to finance the existing HIPC initiative. It has yet to even come up with the additional $5 billion that they would need to fund the initiative beyond 2006. I think they have come up with the resources, up to that point.

Mr. OSE. Is that a function of a financial question, or something other than that?

Mr. CHRISTOFF. We have looked into this a bit. I do not think we have a full analysis of it. But we have looked at the commitments that the World Bank has. It appears that a lot of the commitments are taken up by what they have committed to make to poor country loans over the next 10 years. Mr. Melito can expand on that, if you permit us.

Mr. MELITO. The reserves which you referred to, I believe, are in IBRD, not in the IDA. The way the Bank is currently structured, IDA resources are used for the IDA only, and IBRD, the non-concessionable resources, are used for those purposes only. So there is a firewall between those two funds.

Mr. OSE. So they do not go back and forth.

Mr. MELITO. The profits from IBRD have assisted IDA. IBRD does make money on its loans to middle income countries, but the actual reserves are to stay within the IBRD.

Mr. OSE. Now the 1.6 percent increase in contributions over 40 years, if you compound that over that 40 years, it totals more than $15.6 billion. How do you reconcile that?

Mr. CHRISTOFF. Well, we actually did compound it. The actual additional resources that you need would be about $9 billion. We included the compounding to then come up with the $15.6 billion.

Mr. OSE. All right, my time has expired. I would like to recognize the gentleman from Texas, Mr. Bentsen, for the purpose of 5 minutes of questioning.

Mr. BENTSEN. Thank you, Mr. Chairman.

In your testimony, you said that the Bank is assuming a $100 billion loss, and you are assuming a $15.6 billion present value loss. Is the $100 billion a present value loss that the Bank is assuming, as well?

Mr. CHRISTOFF. No, nominal——

Mr. BENTSEN. Nominal of loss; and if I recall correctly, when we were doing the debt forgiveness legislation, and looking at the 40 or so HIPC countries, you have a lot of debt that is in arrears, anyway. Do you assume, in your calculations, that all future debt, if you were to not go to a grant, or in comparison, do you assume that all future debt is going to be paid; or do you work that into your calculation?

I guess the point I am making is that it is not the most credit-worthy debt, even at a concessionary rate, to begin with. So is the $15.6 billion an optimistic figure, in any event?

Mr. CHRISTOFF. We made the assumptions that is also the assumptions that the World Bank makes; that basically, there is a five percent default on all future loans. So that was implicit in the methodology that we used.

Mr. BENTSEN. So you have a loan loss aspect?

Mr. CHRISTOFF. Exactly.

Mr. BENTSEN. Let me ask you two questions. One is, in your assumptions, do you consider that in the 50 percent grant program, that the grants are actually funded at an equal amount to what the lending would be from the soft window?

My concern on this is more of a policy issue, I guess. My concern is that I think the grant idea is a good idea, because I think your earlier study that showed the unsustainability of the one-time forgiveness thing, going back to the soft window would just sort of put people back in the tank again.

We had the Secretary here last year, where he initially started talking about the idea of going to a grant program. What I am concerned about is whether or not they are willing to put the money up. But you all assumed that in a 50 percent forgiveness, that they would be putting up an equal amount in grants?

Mr. CHRISTOFF. Well, what we assumed, first we determined what the estimate is; what we thought the cost would be at $15.6 billion, and then we determined how much donors would have to pay, in order to fully finance that. That is where we then came up with the 1.6 percent increase.

The whole 50 percent grants proposal is contingent upon whether or not the donors are willing to make the commitment over an extended period of time; 1.6 percent per year, over 40 years.

Mr. BENTSEN. This may not be a fair question to you, but does the Administration's proposal assume, and in your studies, would you assume, if you went to, say, a 50 percent grant proposal, and you showed countries that could become debt sustainable in the total, and then two others, for a period of time, would it be likely or conceivable that those countries could be moved; again, to be moved into the sovereign credit rating system, and start to move away from a soft window to hard window lending?

Mr. CHRISTOFF. We are still talking about extremely poor countries, when we are talking about any of the grants proposals. Even with the additional assistance that they might receive through a grant element, these countries are still going to need a great deal of external assistance.

Mr. BENTSEN. Thank you.

Thank you, Mr. Chairman.

Mr. OSE. Thank you, Mr. Bentsen.

Mr. Gonzalez, for 5 minutes.

Mr. GONZALEZ. Thank you very much, and I apologize for getting here late. Unfortunately, you may have covered this already. But I am always interested, when anyone comes up here with proposals, as proponents of change, what I would like to hear from you is basically those that oppose the change, the rationale.

Let us just assume, for the sake of argument, that it is not going to be the additional contribution, the increase and so forth by the donor nations. That is taken care of. That is not going to be a big issue, policy-wise and otherwise.

If you would tell me the best arguments, to remain more in the loan nature, as opposed to grant, and who would be the proponents of that argument.

Mr. CHRISTOFF. I am not certain if there are proponents of trying to keep the system the way it is. I think there are proponents who are saying that one should go to 100 percent of old debt forgiveness, or there are those who may be concerned about a grant element as being too costly.

I think on the latter, in terms of those that might oppose this proposal because of its cost, I think by looking at it from a present value term, the $15.6 billion is perhaps not quite as ominous as the $100 billion that the World Bank expressed in nominal terms.

There are countries that have been concerned about the cost, Mr. Gonzalez. Some of our close allies initially labeled this 50 percent grants proposal as crazy. But I think it might have been related to the belief that it was an exceptionally high cost associated with the proposal.

Mr. GONZALEZ. So you would say that most of the opposition at the present time is associated with what people perceived to be the cost, which is obviously not borne out when you put the figures that you have presented today?

Mr. CHRISTOFF. Right.

Mr. GONZALEZ. Thank you very much.

Mr. OSE. The gentleman yields back.

Mr. Sanders for 5 minutes.

Mr. SANDERS. Let me deter a little bit away from your report, and thank you very much for your excellent report. Have you done any work which gives us some understanding, given the magnitude of the problems in the development world in subsaharan Africa, about what kind of commitment it would take, not just from the United States, but from the wealthier countries in the world, to significantly improve the standard of living of the poorest people in the world, and bring them up to at least a minimum standard of living, where people have health care, education, clean water, and stuff like that?

Mr. CHRISTOFF. No, we have not done that kind of detailed work, sir.

Mr. SANDERS. My understanding is that the proposal that the President has brought forth, your estimate is that it is $15.6 billion?

Mr. CHRISTOFF. Yes, sir.

Mr. SANDERS. From the United States Government?

Mr. CHRISTOFF. No, that is from all the donors.

Mr. SANDERS. I would then just simply put that into a very broad context, as this Government has provided $400 billion or $500 billion tax breaks to the wealthiest one percent of the population. In over a period of how many years is this $15 billion going to be stretched out?

Mr. CHRISTOFF. Forty years.

Mr. SANDERS. Forty years, $15 billion, and we have parts of the world which are being ravished with AIDS. We have tens of thousands of children who are dying from treatable diseases. We have millions of people who cannot drink clean water. Health care systems are breaking down.

Thank you very much for your work on this. But I think it is certainly not only from a moral point of view, but from our own national security point of view, that we have got to reach the level of understanding that this country will never be safe, that this planet will never exist in anything resembling peace and harmony, so long as some people have so much incredible wealth.

My understanding is that the 500 wealthiest people in the world own more wealth than the bottom 2.5 billion people on this planet. So I would suggest that a contribution of $15 billion over a 40 year period is quite minimal, and that the United States has got to reach out to other industrialized countries.

It is certainly not just our responsibility, but the entire industrialized world is going to have to get together and address the horrendous problems facing the poorest people on this planet. We cannot allow children to die of preventable diseases, while we give tax breaks to billionaires, in my own view.

Second of all, can you make a comment on this? I know that some people believe, and I happen not to, that the way out of misery for the developing world is to export their way out of the problem. Some of us are rather skeptical about that. Do you want to say a word on that?

Mr. CHRISTOFF. Well, I would like to talk about that, just in terms of sort of the expectations that are placed upon developing countries. When you make estimates of their debt sustainability, you make assumptions about how they are going to export their way out of perhaps poverty.

The export growth rates that are used, oftentimes by the World Bank and others, generally are overly optimistic. Their export rates are not based on historical rates that these countries have had. Sometimes they are eight times higher.

Mr. SANDERS. Right.

Mr. CHRISTOFF. So one would not want to then hold those countries up to an expectation over things that they may not necessarily be able to control.

Mr. SANDERS. That is an excellent point, and is it not also true that when you are talking about an export rate, it is not necessarily true that the benefits of that are going to filter down to the poorest people.

Mr. CHRISTOFF. Sure.

Mr. SANDERS. Well, I appreciate your thoughts, and thank you very much for your excellent work. I would yield back.

Mr. OSE. Mr. Hinojosa, for 5 minutes.

Mr. HINOJOSA. Well, thank you, Mr. Chairman.

I also want to thank Mr. Christoff for your presentation. It is very interesting, and certainly, the question I am going to ask is with reference to the maquiladores that we have on the Mexican side, adjacent to all the Texas/Mexico border in McAllen, Texas. Across from the River there is Threnosa, and we have about 150 maquiladores.

Most of the materials we send in from the United States across the river, and we assemble them and bring them back to the United States as finished goods. As I understand it, much of the finished goods is recorded as exports for Mexico. Is that correct?

Mr. CHRISTOFF. I believe it is correct, sir.

Mr. HINOJOSA. That is the way I understand it. So knowing that they simply add the labor and bring them across, there would be very little profit to the country.

Maybe you could explain the rationale, economic or otherwise, for focusing on debt to export ratio as a measure of sustainability. Would it not also be useful to consider debt payments as a share of the country's national budget or debt, as a share of the gross domestic product?

Mr. CHRISTOFF. Sure, I would agree with that. I mean, you have to look at other indicators, such as the total debt that that country has, or their debt stock and its percentage of GNP.

Debt sustainability, we need to remember what it is. When a country is debt sustainable, it simply means that they can manage their existing debt, and they will not need any additional debt relief. So they could have a high amount of debt and still be debt sustainable.

Mr. HINOJOSA. The way I see it is that in the last 4 or 5 years, Mexico has become our second largest trading partner. I think that because of the explanation that I gave you earlier, it makes Mexico look much more prosperous, and certainly the perception is such, because of those millions and millions of dollars that are coming back as finished goods.

So they need a lot of help along especially the Texas/Mexico border and that bank and, and of course, the World Bank are very important entities for us to be able to get the environmental concerns taken care of, with waste water treatment facilities and the huge population that is moving from the central part of Mexico to the border; that 2,000 mile border from California to Texas.

It is amazing how many people have moved and the population increases there are anywhere from 50 to 100 percent, you know, every year; well, not every year, but every decade.

So I think that we need to really see how we can make the adjustments in this effort that is being made by our committee, so that indeed, those folks, our friends to the south, are able to improve their infrastructure.

Thank you, Mr. Chairman. I yield back.

Mr. OSE. The gentlemen yields back.

Mr. Frank, for 5 minutes.

Mr. FRANK. I found this very useful. I had questioned Secretary O'Neill. I do not understand why some of our European friends and some others seem to think it is unfair to countries to give them money rather than lend it to them. I think distrust of American objectives, which may be historically understandable, is a part of it; but it is mistaken.

On the other hand, a refusal by some of the advocates of grants to acknowledge that some more contributions will be necessary to maintain the level is part of the problem. I asked Secretary O'Neill that, and his answer orally was, yes, we would do it. He then wrote a letter back and said he was not sure that it would be necessary.

You say that the Treasury agreed with your conclusions. Did they agree that the $15 billion in present value would be necessary?

Mr. CHRISTOFF. Yes, because the 1.6 percent is what you would need to get to that point.

Mr. FRANK. OK, we have now established, and the Treasury does acknowledge that to hold to the same level of disbursements, you would need that 1.6 percent increase. I think that is very helpful.

Mr. CHRISTOFF. Right.

Mr. FRANK. Because I think many of us are prepared to wholeheartedly support this position, as long as there is a commitment that we will do it. Now we all understand, these are projections. It could be a little more or a little less. But once you have got that order of a magnitude, I think that is a good thing.

Now the next question, this is posed as debt forgiveness versus going to grants. There is an obvious question; why versus? I mean, your view is, one takes care of two countries; one takes care of four countries. What if we did them both?

Mr. CHRISTOFF. If you did both, it could be accomplished. It would be expensive.

Mr. FRANK. How much more expensive than the current one?

Mr. CHRISTOFF. Well, we do not look at the full cost of the debt forgiveness proposal. But it would cost a lot more money to try to erase all of the existing debt burdens of these HIPC countries.

Mr. FRANK. And you have not looked at that?

Mr. CHRISTOFF. Not in detail; but if you think that right now the World Bank has a $5 billion unfunded commitment to the HIPC program, alone, forgiving that portion of the debt would require——

Mr. FRANK. Well, is there a realistic discounting of the debt? I mean, if I offered to sell you the highly indebted poor country debt, what would you pay me on the dollar?

Mr. CHRISTOFF. Oh, I do not know.

Mr. FRANK. It would be not a hell of a lot, I think.

Mr. CHRISTOFF. No, of course not.

Mr. FRANK. Well, let us not artificially inflate the cost of the HIPC. I mean, unless you got some unemployed Enron accountants, who could come over and help you out.

I mean, my sense is, it is a good deal less than 10 cents on the dollar. I do not even know if it has any market value at all.

But to be clear, neither one or the other gets these 10 poorest countries to stay in the building; all of them. The best you do, it is four countries out of ten; versus two countries out of ten.

Mr. CHRISTOFF. Right.

Mr. FRANK. Could I get from you or could you get back to me on what would be, or how many of the 10 would get to sustainability if we did them both?

Mr. CHRISTOFF. We could take a look at that, sure.

Mr. FRANK. And what it could cost—we are already committed to the HIPC. Now you are assuming that we stick with what we have already done with the HIPC, but not go further. Is that when you say it would cost more? You are not counting the cost of what we have already committed to do, are you?

Mr. CHRISTOFF. I am saying anything above and beyond the HIPC debt relief would be additional funds that would be needed, correct.

Mr. FRANK. So your assumption about the four getting to sustainability assumes the current level of HIPC relief, plus?

Mr. CHRISTOFF. Yes, correct.

Mr. FRANK. If we did further debt relief, I would be interested in that. I have one last question, and that is very useful, Treasury would not let you talk to the World Bank.

Mr. CHRISTOFF. No.

Mr. FRANK. Did you want to?

Mr. CHRISTOFF. Well, yes.

Mr. FRANK. Do you think it would have helped the report if you did?

Mr. CHRISTOFF. Yes.

Mr. FRANK. Did Treasury tell you why you could not do it?

Mr. CHRISTOFF. Well, first of all, GAO's protocols with Treasury are——

Mr. FRANK. I understand that they have the power to do it.

Mr. CHRISTOFF. Yes.

Mr. FRANK. But did they give you a reason?

Mr. CHRISTOFF. Yes, they said that because they were in the middle of negotiating the IDA replenishment, it would be inappropriate for the GAO to speak to that.

Mr. FRANK. Let me ask you, does that make the slightest bit of sense to you?

Mr. CHRISTOFF. Absolutely not.

Mr. FRANK. Thank you.

How getting information from the World Bank could interfere with IDA negotiations, is just odd. I must say to the Treasury, many of us want to help them implement this plan, and I was jolted to see that they would not let you talk to the Bank.

I mean, if you are going to dispute with the Bank, I am inclined to be persuaded by what you said. But I would be even more persuaded if I would have had a chance to have your analysis of what the Bank said. I understand you did the best you could. This is not a criticism of you.

But let me just appeal to Treasury. Let me ask, if Treasury changed its mind, would there be any point in your now just double checking with the Bank, or is it too late?

Mr. CHRISTOFF. Well, I think we would like to talk to the Bank about the fact that if the proposal is operationalized, how would they do it.

Mr. FRANK. I appreciate the subcommittee having this hearing, but I think that maybe we could, as a subcommittee, ask Treasury not to prevent you from talking to the Bank. This is an important subject.

Mr. CHRISTOFF. That would be helpful.

Mr. FRANK. It is hard for me to see what Treasury is afraid of, unless they are seeing this as becoming a bad precedent. But I intend to ask Treasury to do that, and I would hope others would join.

Thank you, Mr. Chairman.

Mr. OSE. Mr. Watt, for 5 minutes.

Mr. WATT. Thank you, Mr. Chairman.

I think Mr. Frank may have covered a lot of the things that I wanted to cover. But I confess to being a little apprehensive about how this works.

The President's proposal says that you would replace 50 percent of future loans with grants. You have juxtaposed that against the benefit of forgiving existing debt. It seems to me that just the mathematics of this leave me a little apprehensive.

Mr. CHRISTOFF. Sure.

Mr. WATT. You have got $100 worth of debt, which you are going to leave out there, and you are going to give $50 more in the future and $50 in addition to that in grants.

So you end up with $150 worth of debt, and you are saying that that is better in some way than forgiving $100 that already exists. I am having a little trouble with that mathematics, so help me out, if you would.

Mr. CHRISTOFF. Let me try to explain. The 100 percent debt forgiveness does provide benefits to all the recipient countries, up to a point. The reason why it is up to a point is that the day after you forgive all the debt, those countries' needs are so great that they have to go back and continue to borrow.

So the borrowing will build up, and you reach a point, which is at about 7 years, in which they once again become debt unsustainable.

In contrast, the grants proposal, by replacing future lending, half of it in the form of grants, you are keeping them debt sustainable for a much longer period of time.

Mr. WATT. All right, but I understand that. Then I guess the question I have is, and I guess it is the same question that Mr. Frank had, if you both forgave the debt, which wipes out existing debt, at a minimum, it seems to me, under your proposal, you would expand sustainability by 14 years, I would think.

That is because you would expand that number from 7 to 14 years, even if there were no investment returns, if I understand what you are saying. Am I missing something?

Mr. CHRISTOFF. Well, you are asking us to do what Mr. Frank has asked us to do.

Mr. WATT. OK.

Mr. CHRISTOFF. We need to go back and do that analysis, as well, because I think we do not want it to be perceived as an either/or situation; that perhaps let us take the totality of it, see how much it costs, and let us see what are the derived benefits.

Mr. WATT. That is pretty magnanimous to give away somebody else's money in grants. What part of these future grants come from the U.S., just as a matter of curiosity?

I like the President giving away somebody else's money, but I am just trying to figure out what part of it is U.S. money and what part of it is somebody else's money, that he is proposing to do this future grants program with?

Mr. CHRISTOFF. Well, the United States is a member of IDA. The United States contributes 20 percent of all the resources to the IDA program, itself.

The United States does still give out a lot of assistance to poor countries, and we have traditionally been giving it out in the form of grants, and have been doing that since the 1980s.

Mr. WATT. So our portion of the future 50 percent grants program would be 20 percent.

Mr. CHRISTOFF. Right.

Mr. WATT. Our portion of the debt forgiveness, if you did both, would be 20 percent of what is already outstanding. It would be higher than that, would it not? Because were we not, at some point, a higher contributor than 20 percent?

Mr. CHRISTOFF. For IDA, that is correct.

Mr. WATT. Yes, so this may be some of the President's interesting math here, if you look at it closely. All right, I mean, forgive me for being a little apprehensive, but I think I understand what you are saying.

But I also strongly agree with Mr. Frank, that this proposal would be a lot better if we were talking about doing both of these, as opposed to proposing one.

It seems to me that we do not have much credibility, proposing to do 20 percent of 50 percent, as opposed to 30 or 40 percent of 100 percent. It seems to me that both of them working in tandem would work a lot better.

Mr. CHRISTOFF. Well, we owe you that analysis.

Mr. OSE. You are going to have to come back to that, Mr. Christoff.

The gentlemen from California, Mr. Sherman, for 5 minutes.

Mr. SHERMAN. Thank you. No discussion of the World Bank should ignore the fact that the World Bank has lent substantial dollars to the Government of Iran, which continues to develop nuclear weapons.

Money is fungible. The money we send to the World Bank is fungible with the money from other countries. The money that goes to Iran is partially ours, and they money that they do not have to spend meeting their domestic needs is money directly for their nuclear weapons program.

Just to put this into context, in the year 2000, the World Bank agreed to loan $145 million to worthy projects in Iran. Keep in mind, if an American had sent money to the Nazi Regime during World War II and earmarked it for worthy projects, they could say, well, I am just building hospitals or something. That would have been a crime then. Supposedly, we have a war on terrorism now.

In any case, $145 million was disbursed for one worthy project, and $87 million for another allegedly worthy project, on the assumption that the Government will not simply put the money directly into the Treasury, but will actually spend it on those projects.

I would point out also that just 5 months ago, the World Bank staff circulated a memorandum proposing that $775 million additional dollars be disbursed to Iran.

What we have is bureaucracy's that do not seem to be listening to the country, and who do not seem to notice that September 11th happened. They did not notice the "axis of evil" comment of our President. Their reaction is to simply weakly oppose, meekly vote against, and then acquiesce in our continued funding of the organization that is funding the development of nuclear weapons that may be very well be used against use.

I do not think that that is the focus of this panel. But our continued participation in the World Bank is the continued participation in this process.

We have never threatened to withdraw from the World Bank, or to cutoff funds, or to do anything that would cause the slightest bit of social consternation to our representatives to the World Bank, or raise anybody's blood pressure, just in an effort to prevent Iran from having nuclear weapons because, well, that is not near as important as going along and getting along.

I would also like to focus on an intermediate course between grants and loans. The loans made by the World Bank, and correct me if I am wrong, involve a repayment schedule. In between, we could loan the money with no repayment schedule at all. It would not be quite as good as a gift. It would not be as tough as a loan.

Then if there was some change in the Government and the Taliban took over, then we could change and enforce that loan.

Would that not put us in a stronger position to react to changes in governments, world events, than would a situation where we give the money to a good government today, and before they even spend it, a horrific government takes their place? I do not know if you have a comment.

Mr. CHRISTOFF. Well, when we are talking about the highly concessional loans, first of all, we are talking about poor countries. Those are 40 year loans, zero percent interest, 10 year grace period.

Mr. SHERMAN. So that is pretty much the model that I am talking about, except it is not explicitly tied toward at least no backsliding in, or perhaps even progress toward democracy?

Mr. CHRISTOFF. The loans that you were referring to, to Iran, are not loans that would come out of this particular program. This is the IDA program.

Mr. SHERMAN. But correct me if I am wrong, we could get outvoted tomorrow, and IDA dollars could flow to the government of Sudan. Is that correct?

Mr. CHRISTOFF. Sure.

Mr. SHERMAN. So not only could we be funding nuclear weapons for Teheran we could be funding slavery in Khartoum. All that it takes is for us to get out-voted, and we have been out-voted. Go ahead.

Mr. CHRISTOFF. I almost feel like I need a World Bank colleague sitting next to me, to perhaps defend some of their actions.

Mr. SHERMAN. They believe that they get to do whatever they want, and they do not really think the Iranian Government is all that bad, and they are not sure the Sudanese government is all that bad. I have talked to them at length. But I hope we have an opportunity to hear them testify.

So you are saying that there is a structure for highly concessional loans that is between regular loans and grants, and I am glad that structure exists, and I hope it is explored, along with the idea of shifting to a grant program. I yield back the balance of my non-time or my non-balance.

Mr. OSE. The gentleman's time is expired.

The gentlelady from Indiana, Ms. Carson, for 5 minutes.

Ms. CARSON. I have a dumb question. These are the intellectuals. I am the naive one. What happens when you go to 10 or 14 years, and the country has not replenished its financial obligation or its debt; what happens?

Ms. CHRISTOFF. More often than not, additional loans are given to pay for those that have not been repaid, or it is rescheduled.

Ms. CARSON. Before you give the loans or the grants, as proposed, do you have some test on accountability, stability?

Mr. CHRISTOFF. Well, the World Bank, at least through the HIPC Program, places a lot of conditions on the existing loans that it has. It wants those countries to try to achieve some macro-economic reforms. It wants it to focus some of its poverty reduction programs in certain areas, like health and education.

Ms. CARSON. I have no other questions, Mr. Chairman.

Mr. OSE. The gentlelady yields back the balance of her time.

Is it the pleasure of the Members to go another round, or do you have additional questions? I have two. Would you like to go another round here? All right, to the extent that you have questions.

Mr. Frank brought up what I thought was a very important question, and that was, when you refer to the $5 billion in unfunded World Bank obligations at present, is that the face value of the paper, or is it the present value?

Mr. CHRISTOFF. The present value.

Mr. OSE. So that would be the market valuation on that paper?

Mr. CHRISTOFF. Taking into account, right, the inflation.

Mr. OSE. If you went out into the market place to buy the paper, it would cost you $5 billion?

Mr. CHRISTOFF. I do not know, would it Tom?

Mr. OSE. Mr. Melito.

Mr. MELITO. There is no market value for this debt. This is not publicly traded debt, and it would be very difficult to know what that market value is.

I want to say that it is $5 billion in present value, but it is mostly in the recent years, so the present value and the nominal value, in that case, are fairly close to each other.

Mr. OSE. Well, I think Mr. Frank raises an interesting question. Why would we pay $5 billion for something that potentially has no value?

Mr. MELITO. The resources of IDA depend on several things; one of which is repayments from recipient countries. When we talk about the cost of forgiveness, one of the things you must think about is, where does IDA come up with an alternative source of money to make the loans it is scheduled to make in the future.

So when the $5 billion shortfall is considered, it is considered as a possible funding gap for the World Bank. Any additional forgiveness of multilateral debt would be an additional potential funding gap, and the expectation of the donors would have to make up some of that, if not all of that gap.

Mr. OSE. I am not quite sure I understand your point. I am trying to get at, if the World Bank has an outstanding obligation or a commitment of $5 billion for HIPC debt forgiveness, and that debt has a market value, arguably of zero, then do you not have to write the thing down to zero?

Mr. MELITO. From a financial perspective, that is correct.

Mr. OSE. Otherwise, we are going to go off, as Mr. Frank suggested, using Enron's accountants.

Mr. MELITO. There is a financial perspective, which I agree with.

Mr. OSE. Or for that matter, a Global Crossings' accountant.

Mr. MELITO. There is also a public policy issue, as well, though. People wish for IDA to stay engaged in poor countries in the years ahead. There is a desire to increase its resources to poor countries. This $5 billion is currently committed, but there is no actual source of it. That is the cost, or that is the gap.

Mr. OSE. But it committed to debt forgiveness.

Mr. MELITO. Well, but it is also part of their future asset base. That is the complication.

Mr. OSE. That seems like paper with ink on it that has no value, to me.

Mr. MELITO. Yes.

Mr. OSE. My second question has to do with the manner in which IDA funds loans. It is my understanding that on a project that IDA is involved in, the country makes a contract with someone who will build it. The contract is presented to IDA. IDA never pays the country. They pay the contractor directly. Is that correct?

Mr. CHRISTOFF. I do not have the details on that.

Mr. OSE. The question really is whether or not the money gets co-mingled.

Mr. CHRISTOFF. We have not looked into that, in terms of the procurement practices, no.

Mr. OSE. All right, Mr. Bentsen.

Mr. BENTSEN. Thanks, Mr. Chairman.

I think what you are saying is the $5 billion, it is cash flow, and that they need cash flow, so that they can keep lending.

But it begs the question as to, if you are going to lend money for 40 years at zero years, and really, 50 years with a 10 year grace period, you are going to have an evaporation. It may have a negative arbitrage. You are going to have a loss on the money.

So even though at the 50 percent level, you all calculated about a $15 billion or $16 billion cost of funding half of future commitments through the form of grants, it is not as simplistic as doubling that, I do not think.

But I am curious whether or not you could look and see really what the projected cost in present value terms would be, if you just went, for the HIPC countries, to a full grant program.

Because, again, you have got a five percent loss rate, and you are getting negative returns at zero percent. So over a very extended period of time, we may want to re-think this. That is a policy issue, but you all should look at that.

How much of the portfolio of IDA are the HIPC countries?

Mr. CHRISTOFF. I will have to submit that for the record. We do not know at this point, sir.

Mr. BENTSEN. I mean, it seems to me, if it is a majority, then I think we really want to think about re-doing IDA. If it is two-thirds or something, you can always create a soft window lending vehicle, but it is a losing money venture right now on both ends. So it would seem we would want to make a change. But if you could find those answers for me, that would be helpful.

Mr. CHRISTOFF. And also, if I heard you correctly, that is looking at 100 percent grant forgiveness for the HIPC countries.

Mr. BENTSEN. Right, if you could determine that. I think you ought to be able to figure out a present value cost of that, with the loan lost rate, and the negative costs, assuming an inflation rate going out.

Thank you, Mr. Chairman.

Mr. CHRISTOFF. Absolutely.

Mr. OSE. The gentleman yields back.

Mr. Gonzalez, anything else?

[No response.]

Mr. OSE. Mr. Hinojosa, anything else?

Mr. HINOJOSA. I have no further questions.

Mr. OSE. OK, Mr. Frank.

Mr. FRANK. On the valuation question, which is an important one, we did do some bilateral debt relief, as I recall. Do you remember what the discount figure was, that was applied to that?

Mr. MELITO. It was approximately nine cents on the dollar.

Mr. FRANK. Nine cents on the dollar, OK, yes, and obviously, I assume when we talk about future HIPC debt relief, there is no reason not to use the same figure.

So was $5 billion the future highly indebted country debt?

Mr. MELITO. That is the projected cash flow loss, Mr. Frank, for the World Bank, from its involvement in HIPC, II.

Mr. FRANK. So we would be talking about a cash amount of $450 million.

Mr. MELITO. They are valuing it at 100 cents on the dollar, yes.

Mr. FRANK. Yes, but if you apply to that outstanding HIPC debt the discount figure that the Office of Management and Budget told us to apply, same debt/same country, I mean, there is no qualitative difference that jumps to mind. You would be talking about $450 million, not $5 billion.

Now over the 40 years, to replace the reflows from loans to a 50 percent grant, you said was $15 billion, approximately?

Mr. CHRISTOFF. Yes.

Mr. FRANK. And that would be a 1.6 percent increase.

Mr. CHRISTOFF. Right.

Mr. FRANK. All right, well, if $15 billion meant a 1.6 increase, does somebody have a calculator; what does $450 million do? It is a pretty minuscule one.

So in other words, by using the discount rate that OMB gave us for debt, it would only cost us $450 million in the same realistic terms, for the future. Let me see, that is three percent, I think, of $15 billion would be, $150 million would be 10 percent, and $450 million is three percent. So what is three percent? That is not a lot of money, 1.6 percent.

We are talking about further increasing by 3 percent of 1.6 percent, so it seems pretty minuscule. So I take it from that, that if we were to stay consistent with OMB's view of the debt in the future, now maybe you could argue that if you were to switch from loans to grants, then the value of the future debt might be a little greater, because they would be under a little less strain and they would have a little more money. But it is still clearly minuscule.

So that strengthens my view that we ought to be doing both, if we are talking about an additional $450 million on what is a $15.6 billion cost. It seems to me, just a little bit above de minimis.

Thank you, Mr. Chairman.

Mr. OSE. The gentleman yields back.

Mr. Watt, anything else?

[No response.]

Mr. OSE. Mr. Sherman.

Mr. SHERMAN. I have just a little bit more here.

Mr. Hinojosa brought up the issue of how they account for imports and exports. In his example, would the export value be just the value added in Mexico, or would it be the entire value of the goods being shipped, including the original value of the American fabric; or is this just something you do not know?

Mr. CHRISTOFF. I do not know.

Mr. SHERMAN. I yield back.

Mr. OSE. The gentleman yields back.

We want to thank this panel for joining. Mr. Christoff, Mr. Melito, we appreciate your testimony and your insight.

Mr. CHRISTOFF. Thank you, sir.

Mr. MELITO. Thank you.

Mr. FRANK. Mr. Chairman, could I get unanimous consent to make a request?

Mr. OSE. Well, you can always make a request.

Mr. FRANK. My request would be that we sponsor a witness school with these two people, for almost everybody else who comes and testifies, and dances and evades. This was the most straightforward testimony that I can remember getting in a long time.

Mr. CHRISTOFF. I thought you were going to put me in the "dancing and evades" category for a second.

[Laughter.]

Mr. OSE. You have got to watch him, I have got to tell you. Thank you for the suggestion, Mr. Frank.

Again, I want to thank this panel for joining us today. Just as a heads up, we will leave the record open, so you may get some additional questions.

Mr. CHRISTOFF. And we owe you some things.

Mr. OSE. Right, we will be sending them, and it will be open for 10 days, I believe. Anyway, thank you for coming.

Mr. CHRISTOFF. Thank you, sir.

Mr. OSE. You are excused.

We are going to enter for the record a CRS report for Congress on IDA loans versus IDA grants, dated February 8th, of 2002.

[The referenced material can be found on page 126 in the appendix.]

Mr. OSE. I am going to invite the second panel up to the witness table. We will take about 2 minutes here.

[Recess.]

Mr. OSE. I would like to welcome the second panel to our subcommittee hearing. Our second panel, as I said, has four panelists to testify on the current status of the North American Development Bank.

We will hear today from the Honorable Victor Miramontes. Mr. Miramontes is currently the President and COO of American City Vista, where his responsibilities include operations, finance, and project development. Prior to this position, Mr. Miramontes served as Managing Director and CEO of the North American Development Bank.

He holds a Bachelor's and Master's Degree in Economics from Stanford University, and I want to say that is the Stanford Junior University, and a Law Degree from Stanford University, as well. I went to Cal, so we will overlook your transgression.

In addition, joining us today is the Honorable Jose Aranda, Jr., the Mayor of Eagle Pass, Texas. He will testify here on this panel. Mayor Aranda was first elected in 1998. He is in his second term.

Eagle Pass is a border town, which has direct interaction with the North American Development Bank and the BECC.

Mayor Aranda, who was suggested as a witness by Representative Bonilla from Texas, is also Chairman of the Texas Border Infrastructure Coalition.

Our third panelist is Mr. Ernesto Silva, the City Manger of Mercedes, Texas. Mr. Silva was suggested as a witness by Congressman Hinojosa. As City Manager, Mr. Silva has had a direct involvement with North American Development Bank, coordinating in Mercedes a water treatment plan expansion, a master drainage and paving program, and a master waste water interceptor program.

Mr. Silva began his work in Mercedes in 1997, after serving the previous 10 years in the city of Farr, Texas, also as City Manager, coordinating similar infrastructure projects.

Our final panelist, Mr. Don Gonzalez, was suggested as a witness by Representative Gonzalez. He is the Executive Vice President and Manager with the investment banking firm of Estrada Hinojosa & Company, based in San Antonio. He has direct experience working with border communities in obtaining financing from the North American Development Bank.

I know that Mr. Gonzalez had a request in for the purpose of an opening statement at this point, and in the subcommittee's deliberations, the gentlemen is recognized.

Mr. GONZALEZ. Thank you very much, Mr. Chairman. In the interest of time, I do have a statement to make. However, I am really anxious to hear the testimony and the questions that will be posed to members of this panel.

So I will be submitting my statement in writing, to be made part of the record, as well as comments and statements from Congressman Solomon Ortiz, Sylvester Reyes, Mayor Ed Garza of San Antonio, and the Free Trade Alliance of San Antonio, all of whom are strong supporters of NADBank.

With that, I yield back, sir. Thank you.

Mr. OSE. The gentleman yields back.

With that, we are going to go to our panelists. We will go first to Mr. Miramontes for the purpose of a statement. We have received each of your written testimonies, and we have reviewed them and read them. To the extent that you can, we would like you to summarize within that 5 minute period.

Mr. Miramontes, you are recognized.

STATEMENT OF HON. VICTOR MIRAMONTES, PRESIDENT AND COO, AMERICA CITY VISTA

Mr. MIRAMONTES. Mr. Chairman, first of all, I must say I come here as a Stanford graduate. I respect all Cal graduates. I see you have changed the curtains here to match the colors. But once again, thank you very much for inviting me.

Mr. Chairman and Members of the subcommittee, I thank you for invitation to appear before you today. I will not read from my written comments, but I would encourage your staffs to read them, because there are issues here that are fairly complex, but very, very important for the future of the citizens of the border region.

I have read my colleagues' comments at this table, and I can say that I agree with most of the issues being presented today. There are issues in conflict, not because the people at the table are in conflict, but because the issues of the border are very complex and creative what I call inherent conflicts, given the poverty, the growth, and the pressures that we see up and down the border.

I would focus, therefore, rather than go through the specific presentation that I submitted, on the key issues that are being examined today.

First of all, the border region is one of the fastest growing regions throughout the world, and especially the United States. The one thing that the people from the border share in common is that we know there is a better future for us, as we learn how to exercise our intellectual, political and economic capabilities. We have great pride in our region, and we know that things will get better, as we grow and improve our own skills.

Second of all, I need to point out that the NAFTA process almost 10 years ago created incredible expectations. There were expectations at all trade levels. But for the border, what the expectation was, was that a bank was being created that was being funded with $3 billion in grants; and if not grants, paid in capital.

That expectation, to this day, has been one of the major sources of disillusionment on the parts of many border communities, because the amount of paid-in capital was a fraction of that.

Successes have occurred over the past 10 years. I would like to just point out a few very simple facts. Over six million people over the past 10 years have received additional service from the programs created from the NADBank BECC process. I cannot say that if the Bank and BECC had never existed, would that many people have been served.

But I can tell you this. Over the past 10 years, more projects have been done along the border more equitably, especially in smaller communities than virtually in the entire history before that period of time. This is a better way of dealing with the issue, although there are major hurdles to overcome.

The key to this is that long-term operations and visions for a community must be incorporated into the short-term fiscal needs; typically, grants. But the long-term operation and maintenance and governance issues that must be met are the solution for the future needs of the border communities.

The Bank's lending program, frankly, does not work. That is the simplest way to say it. The reason it does not work is because the majority of the communities on the border cannot afford market rate loans, and there are much better alternatives for loans for environmental projects on the other side of the border.

Therefore, the charter of the Bank needs to change, and needs to be amended to address the fact that it is currently unable to lend to its current capabilities.

While the Bank's primary lending programs have failed, the creation of the Bank and the BECC have truly improved EPA's ability, though, to deliver and to fund projects along the border. This was an unintended, but very good, consequence.

As it relates to the questions posed to me and to the question about the proposal set forth in Monterrey, Mexico, by the Presidents, I would like to make the following comments.

First of all, I do believe expanding the Bank's capabilities south of the border is a positive step. It must be done judiciously, but I think it is a very positive step.

The border region is impacted literally from every part of both nations' trading routes. Trucks from Chicago destroy the streets of Eagle Pass as they drive through. So there needs to be a recognition that trade moves great amounts of traffic through very small crossing points. Those small communities bear the brunt of the majority of that traffic and issues that are related to that type of growth.

Second of all, the reform is proposed that the two boards of the BECC and the NADBank be merged. I do not oppose that concept, as long as the ability of the board to merge its interests of the two institutions are done appropriately.

The problem is, both institutions have very different missions, and we need to respect the fact that each mission must be met appropriately.

This is the core of my recommendation. What I would recommend is that the Bank's charter be amended very simply. It should be amended to allow all infrastructure projects to qualify for the Bank's loans.

What I would do then, because that is a very broad mandate, is give 100 percent of the power to determine which infrastructure program is appropriate to the Board of Directors of the Bank, and if it is merged, the BECC, also.

Currently the Board of the Bank is controlled by the two governments. Treasury and Hacienda alternate chairmanships. So this is not a delegation of this authority beyond the U.S. Government and Mexican Government. It is an appropriate delegation of this authority.

It is inappropriate, though, for this issue to come back in 5 or 10 years, and try to renegotiate a bilateral agreement, again.

I would suggest we fix this once, and let future administrations determine what is the appropriate use of that mandate, how it should be applied; and the Congresses in the future should decide how much money should be applied.

In essence, Mr. Chairman and subcommittee Members, I would say that many good things have come out of this process. There is a fundamental flaw in the Bank's charter. It needs to be addressed. I suggest it be addressed once. It should be done intelligently, and with a full public process that begins, I believe, today.

I do appreciate the opportunity to be here. I will limit my comments to that, and make myself available for questions further in the testimony.

Thank you.

[The prepared statement of Hon. Victor Miramontes can be found on page 94 in the appendix.]

Mr. OSE. Thank you, Mr. Miramontes.

Mayor Aranda, thank you for joining us. You are recognized for 5 minutes.

STATEMENT OF HON. JOSE ARANDA, JR., MAYOR, EAGLE PASS, TEXAS

Mr. ARANDA. Thank you, Mr. Chairman.

I certainly appreciate the opportunity to address this group on an issue that is really very important to the community of Eagle Pass; but not only Eagle Pass, but Maverick County.

What I would like to present to you is the process that we have gone through and the experience that we have had with NADBank and BECC, in reference to our regional project.

As you know, Eagle Pass is located right on the border, and Maverick County has had a 30 percent increase in population since 1990, according to the Census of 2000. Part of the problem, just like any other border community in Texas, is that our poverty level is very high, 46 percent. Out of the 254 counties in the State of Texas, we rank number five, or 250, excuse me.

What I would like to talk to you a little bit about is the fact that the city of Eagle Pass has gone through a lot of growth. This has caused us to take a look at the possibilities of having a new water treatment plant.

At the same time that this was occurring, because of the growth and the fact that our plant was such an old plant, a 1949 plant, and all the requisites that we have to be able to have better quality water, it has really put a strain on the system.

So we were looking, and at the same time, outside of Eagle Pass in Maverick County, there exists a regional or a rural water supply corporation called El Indio Water Supply. This water supply system, which started off really just being a rural water supply area, has already half the capacity for 1,400 connections. At this point, it is already over 2,000.

I am not very much of a technical person, but I will tell you that the most important thing that I would like to present to you is the fact that drinking water is very important to all of us. It is something that is taken for granted in many communities, but in this rural area, it has really become a problem.

You are talking just opening up the faucet and getting murky water, getting dirty water, to the point that the Texas Natural Resource Conservation Commission has cited the system already, and has asked the system to do something different.

The problem that El Indio Water Supply Corporation has had is that it would like leadership to be able to get these things done. The city of Eagle Pass system had been encouraged, had been asked by not only the NADBank people, EPA, the Texas Water Development Board, to look at the possibilities of merging the systems.

With that intention, the city of Eagle Pass looked at it very closely. We studied it, and we came up with a plan, together with BECC and NADBank and the Texas Water Development Port.

The project, in itself, for the city of Eagle Pass, would be a total of $53 million, and the El Indio Water Supply's portion would be for almost $48 million.

You would say, well, why the big difference, when you are talking about 2,000 customers, as compared to 10,000 customers within the system of Eagle Pass. I go back to the issue of how antiquated and how limited the El Indio Water Supply system is.

So the important point here that I am trying to make is that Eagle Pass is really coming to the rescue of a system that needs a lot of assistance. It is something that we consider to be our moral obligation.

The city, in effect, is proposing to help prevent the health threats associated with the inability of a water supply corporation to provide potable water to its estimated 10,000 to 14,000 residents.

The city has no responsibility to extend this service to residents that do not reside in the city, but we have recognized that it is our moral obligation to do this.

The project also will benefit the economic and residential projects that are proposed by the Kickapoo Traditional Tribe of Texas, that is within this region. Overall, it is a project that we feel is needed for the overall growth that we have had.

The concern that we have is that the NADBank has offered assistance, but it has not been sufficient assistance. It is offering $14 million of payment assistance or debt service, to be able to help with the debt service for 7 years. But the concern here is that $14 million, plus $4 million that they are offering in the construction proposals or construction money, will not be substantial enough to be able to reduce the rates.

We are looking at the possibility of having a 50 debt ratio at the end of 7 years. This is something that, in our opinion, would be very difficult to operate a system with such a high debt ratio.

The bottom line is, what we are looking at here is that this type of operation, this type of regional system that we were encouraged to be able to offer the residents of Maverick County is something that NADBank is not really ready to be able to deal with, because they do not have the formulas and the monies to be able to deal with two systems that are becoming one.

There are only a certain amount of monies that can be available to us, and we are asking for your help, and we are asking for NADBank's help, to be able to influence how to be able to change those formulas.

Pretty much, that is the concern that we have in dealing with NADBank. We feel that everything else that we have been dealing with has been very, very good.

The relationship that we have established is based on professionalism, and we encourage the support of being able to support projects like the Maverick County project or the Eagle Pass project. That is certainly an example for the rest of the border, when we are trying to create bigger projects, to be able to serve more people, and thus, be a more manageable system, and a better, more efficient system.

Thank you.

[The prepared statement of Hon. Jose A. Aranda, Jr. can be found on page 66 in the appendix.]

Mr. OSE. Thank you, Mr. Mayor, we appreciate your testimony.

Mr. Silva, as I said, we do have your statement for the record. We welcome you. You are recognized for 5 minutes to summarize.

STATEMENT OF ERNESTO SILVA, CITY MANAGER, MERCEDES, TEXAS

Mr. SILVA. Thank you, Mr. Chairman, and good morning, Members of the subcommittee.

I will attempt to give you the local perspective in 5 minutes of a 6-year relationship that the city of Mercedes has had with the bank.

For those of you that are not familiar with our small community, it is in South Texas, located on the U.S.-Mexican border. It has a population of 14,000. It has a sixteen percent unemployment rate and a 52 percent poverty rate. The average income is $5,237. The average home value is $29,500.

As you can see, the city of Mercedes, like many of the other border communities, is a distressed community. More importantly, it has 30 colonias outside of its corporate limits, with 8,000 residents.

In 1991, the Texas Water Development Board adopted the Economically Distressed Areas Program to provide funding for municipalities and rural supply corporation to bring water and waste water facilities to colonia resident, which are residents living in substandard subdivisions that are often referred to as Third World conditions.

Our NADBank experience began in 1996. We were the guinea pig. We were the first to receive funding from the NADBank. We received a $1.6 million loan from the North American Development Bank, at an interest rate of approximately nine percent.

Two years later, in 1998, the bonds were refunded, and the city of Mercedes sold tax exempt bonds at four and-a-half percent interest rate.

The reason we did this was construction had not begun in 2 years, and the city had begun to make payments on the loan, and the interest rate was too high.

In an effort to rectify the situation, the city of Mercedes, along with Mr. Victor Miramontes, the other panelist here, began some extremely high profile meetings. There in these meetings, what we identified was that the city of Mercedes, just like many of the other communities in Texas that were going through the NADBank process, was not prepared to undertake the loans that were being given to them.

During this process, what we identified was that the city had to take an institutional development, as we called it then. We had to upgrade the city's financial management system. We received a grant from the Rio Grande Empowerment Zone for $250,000.

We conducted a water and sewer rates study. NADBank funded that at $30,000. We conducted a sanitation rates study that was funded by NADBank at $18,000. We conducted an in-flow infiltration study that was funded by the NADBank at $120,000. We established a debt service that was funded by the NADBank transition assistance at $450,000.

We implemented a repair and replacement reserve that was funded by the NADBank transition assistance at $250,000. We implemented a water meter replacement program that was funded by the North American Development Bank in the city at $850,000.

We adopted a water and waste water facilities plant that was funded by the BECC and the city at $190,000. We adopted a 5 year capital improvement plan at $50,000 that was funded by the city. We also adopted a 7 year operational budget, along with a 7 year water and sewer rate study.

This is extremely important. This approach was different than the approaches that had been taken in the past by the North American Development Bank and the BECC. It provided a comprehensive understanding of the city's utility system and its functions.

More so, it also provided an additional $12 million worth of infrastructure that had to be funded by the city over the next 5 years.

The Bush and Fox plan that we have been asked to comment on, the extension of the 100 kilometers to 300 kilometers in Mexico, we feel would not be a problem, especially when the America cities have the opportunity to request funding from other State and Federal agencies.

We also feel that one of the major issues that we are facing is the expansion of the program by the North American Development Bank to fund those projects dealing with health care, waste disposal, hazard waste, and transportation.

Two of the major obstacles that I foresee with the North American Development Bank process is the procurement of projects. The procurement of projects takes an extremely long time, as much as 6 months.

Also, besides procuring the project, there has to be an understanding between State and Federal agencies to accept the engineering plans, or what we call a facilities plan, so that these facilities plans can be utilized by both Federal and State agencies, along with the county agencies.

For the most part, you can undertake a facilities plan with the Texas Water Development Board, and then you have to take it back and do another one for the North American Development Bank. These processes take about 6 months to a year to complete.

In closing, I would ask that the Charter of the Bank also be amended to include other programs and be expanded, and more importantly, that the procurement process be changed, and also that there be a standard engineering plan that would be accepted by all parties, when the cities go to request funding from the State agencies, along with NADBank and the BECC.

Thank you.

[The prepared statement of Ernesto Silva can be found on page 110 in the appendix.]

Chairman BEREUTER [Assuming Chair]. Mr. Silva, thank you very much. I am Congressman Doug Bereuter. I do apologize for not being here earlier. The Speaker gave me, unexpectedly, some duties related to the visit of the Canadian Speaker of the House of Commons.

This hearing today is of special interest to me, and especially to the Members who are gathered here today. So we very much appreciate the fact that all four of you have come in.

I think now we would like to call on Mr. Don Gonzales, Estrada Hinojosa & Company, Inc. As mentioned by the Vice Chairman, Mr. Ose, you may summarize your statement. The entire statement will be made a part of the record.

I do want to thank Mr. Ose for his help in chairing the subcommittee this morning. Please proceed.

STATEMENT OF DONALD J. GONZALES, EXECUTIVE VICE PRESIDENT, ESTRADA HINOJOSA & COMPANY, INC.

Mr. GONZALES. Thank you and good morning, Mr. Chairman and Members of the subcommittee.

My take on the NADBank and the BECC process is slightly different from the perspective of being more technical in nature. I am going to try to summarize my comments to that effect.

Our firm has done a significant amount of work with border communities in taking them to the BECC and NADBank, as well as other agencies. We also serve as a financial advisor to the North American Development Bank on projects that we have no involvement with.

One of the things that we see that I think can very much help taking the NADBank to the next level with the BECC is some of the things that have already been mentioned. I think one of the critical ones is trying to bring about some type of standardization in substance and in form with respect documents, applications, that need to be submitted to various agencies.

That will definitely streamline the process. That will help to bring about not only a shorter review time, but also an information sharing process that I think has been developing, but is still not to the point where I think everyone would like to see it.

With respect to the reforms that have been discussed with respect to Presidents Bush and Fox, I think there are a number of avenues there that can, I would recommend, be explored. When we look at going from 100 kilometers to 300 kilometers, that region, we think, can be of assistance in terms of leveraging the paid-in capital of the Bank.

In doing so, if those benefits that would ensure to that region would be earmarked for the benefit of the priority region within the original 100 kilometers, then I think that you will also be able to provide additional grant assistance to that 100 kilometer region. That region still needs to be maintained as the focus.

Without specifically addressing that with additional grants to maintain affordability and sustainability, the projects themselves are not going to be solved purely with just money. They need to be looked at from both perspectives, and cannot be seen as mutually exclusive. We feel very strongly about that.

The other point, in dealing with the expanded region, if you were to look at infrastructure projects, such as what Mr. Miramontes mentioned, and you are able to make more market rate type investments and loans to those areas, I think the Bank will be able to not only expand its capital, but be able to generate better returns than what they probably would be able to generate, given the current 100 kilometer region.

The 100 kilometer region really needs to be primarily just grants and a limited amount of the low interest rate loans. Currently, the loan interest rate program, at $4 million and $8 million, respectively, have a very limited impact when we talk about projects that are in the $20 million, $30 million, or $50 million range.

They are larger, regional-type projects, and the benefit that would actually come to the communities that need these types of projects, it is just not enough to fill the gap.

When we look at competitiveness, current interest rates for communities that are investment grade can be significant, in terms of what they can obtain right now in the market place in the tax exempt basis, whereas, the NADBank, prior to the low interest rate loan program was, as Mr. Silva mentioned, in the seven, eight, or nine percent range.

The way that they were being made more affordable was by blending grant assistance in with the high interest rate loans, to essentially blend down the interest rate to something more affordable, but still looking at something in the seven percent interest rate range.

That is not going to be a project that is going to be affordable and sustainable over the period in which these projects will have their useful life, and the amount of time with which they are going to be repaid to the Bank.

Another item that I think is important to emphasize is in looking at trying to merge the two boards of the Bank, that is an issue that may need a little bit more time than we have the ability to express to you.

But I think that the emphasis from the BECC has been to really focus on the environmental and engineering side of the projects. That emphasis has been there. It makes sense that it would continue to be there.

The financial emphasis of the NADBank and the areas that they have been focusing in on have not only been on the debt side, but also on the operations and maintenance side, and looking forward to sustainability of the projects.

With both of these pieces separated, there has been a greater focus given to each one. Whether they are done under one board or under two boards, we will leave that to this subcommittee and other's infinite wisdom. But I think the main thing that is critical here is that the financing piece really needs to remain a very strong emphasis.

With that, I see we are about out of time. I would like to answer any questions, and thank you again for the opportunity to come before the subcommittee.

Chairman BEREUTER. Thanks to all of you.

In order to expedite the question period for the subcommittee, I, without objection would like to make my entire opening statement a part of the record.

[The prepared statement of Hon. Doug Bereuter can be found on page 48 in the appendix.]

Chairman BEREUTER. I would have tried to set the context through that statement, but I want to just summarize the Board, as it exists today, with respect to the reforms that have been suggested.

With respect to proposals to reform the NADBank, Presidents Bush and Fox formed a bi-national working group that held a series of discussions with States, communities and other stakeholders in the border region. The purpose of generating plans for reform was to strengthen the performance of NADBank and the BECC.

As a result of the meetings, the two Presidents came forth with a joint reform proposal. One of the reforms would expand the jurisdiction of NADBank and the BECC only in Mexico from 100 kilometers to 300 kilometers from the border. Many of you have already referenced that.

The jurisdiction of NADBank and BECC in the U.S. would remain unchanged under that proposal. Additional reforms would increase the capacity of the NADBank to provide grants and low interest loans by doubling the low interest rate lending facility to $100 million, and establishing a $50 million grant financing allocation.

The Presidents' proposal would provide a change, as mentioned, by Mr. Gonzales, in the organizational structure of NADBank and BECC through creation of a single Board of Directors to oversee both institutions. I noticed you wisely sidestepped that and left that to us.

The Board would have representation from both countries; the Federal Government; the four U.S. border States of California, Arizona, New Mexico, and Texas; as well as representatives from those border States in Mexico; and from the public.

In addition, the subcommittee needs to begin examining H. Res. 355, which was introduced by Representative Gonzalez of Texas, and which is co-sponsored by at least 10 additional House Members. This resolution would afford alternative recommendations for reform to the NADBank.

While this resolution would allow the NADBank and BECC to remain separate entities, it would require a review and subsequent improvement of BECC's certification process. The resolution also expresses the sense of the House that the Boards of the BECC and the NADBank should consult with interested parties in exploring options for better follow-up on projects.

Additionally, Mr. Gonzalez's resolution, among other things, would allow the remaining paid-in capital and callable capital to be lent without BECC certification for non-border and non-environmental infrastructure projects.

I hope I have summarized it correctly. Perhaps I have hit some of the high points that Mr. Gonzalez will bring to our attention.

With that kind of a context for the record and perhaps for our discussion here, I would like to begin the 5-minute question period by turning first to Mr. Bentsen and then Mr. Ose and so on, in accordance with Members' appearance here.

While we are going to operate under the 5-minute rule, I assure you that we will come back and make sure that Members have a chance to take advantage of the wisdom in front of us.

Mr. Bentsen.

Mr. BENTSEN. Thank you, Mr. Chairman, and I want to thank our panelists for being here today.

Mr. Miramontes, in your testimony, you said that one of the real problems with the lending facility under the NADBank structure, specifically on the United States' side of the border, to begin with, the projects that could be lent under the current Charter can be funded with tax exempt rates, as opposed to taxable rates, which is what NADBank can fund out; albeit, as you also stated, a number of the credits are non-investment grade, so they are paying 200 or 300 basis points higher, but nonetheless, they may not eclipse the taxable rate.

Given the fact that you have a grant funding aspect, would it not make sense for Congress to take a look at what it did, for instance, under the Clean Water Act, when it allowed the States to set up the revolving fund, either to provide a guarantee or set up a bond bank type structure, using NADBank for eligible projects in eligible communities along the border, to allow them to take advantage of the tax exempt rates.

If I recall correctly, unless specifically noted in the code, a Federal guarantee of a tax exempt structure is a taxable event. So it would take a change in law to do that.

But number one, would it be possible to structure a program like that, that would make the NADBank a more flexible financing facility?

Number two, and I say this very carefully, because I do not want to appear to be trying to take advantage of one side or the other, the capital is paid in equally by both the Government of Mexico and the Government of the United States. is there a loan rate differential between lending for projects in Mexico, versus projects in the United States; and if so, is that a formula based upon what market loan rates would be?

Mr. MIRAMONTES. Let me address the first question. I was actually the first employee of the bank. I remember I walked into Treasury, and in my statement, I also mentioned that the 7 years I was there were some of the hardest years, but I loved every minute of it. I really did.

But I remember walking into the U.S. Treasury and proposing a concept that talked about using the Bank's funds to guarantee, and my proposal lasted about 3 minutes. It is a tax issue. A Federal guarantee cannot support a tax exempt issue without losing the tax exempt status.

The North American Development Bank is an international institution, so we explored ways of trying to come up with mechanisms that would allow it to guarantee, maybe with the Mexican portion of the funds, a U.S. tax exempt security, and not result in its loss of tax status. It is a complex issue. But if there were specific approval for that, I believe then it is possible.

The SRF funds work. The State revolving funds work. I believe that is the right mechanism for environmental projects, on both sides of the border.

Basically, I do not care where you go in the world, environmental projects are very expensive, and they rarely can be built without substantial support from typically Governmental sources. So you do need that on both sides of the border.

The problem that Mayor Aranda has in Eagle Pass is very specific. He is doing the right thing. He needs to merge two major systems. There is not enough money available for that kind of a project. So that is one thing we have to figure out, in terms of how you make those kind of pools of money available.

Number two, in terms of, is there a differential in the loan rates, the answer is no. The market rate program requires you to look at the credit, and you price it accordingly. There are some Mexican projects that actually have lower rates than U.S., because they are better credits; and there are some U.S. projects that have lower rates than Mexican because they are better credits.

So on the market side of the equation, it is a credit analysis that determines the rate.

Mr. BENTSEN. And if I can just ask this quickly, if you did have a tax exempt portion, as allowed under U.S. law, what you could do, Congress could make that happen, as we have under the SRF, and then there would be a loan differential rate, between the projects in the United States and projects in Mexico.

Mr. MIRAMONTES. There would be in that case, yes, sir.

Mr. BENTSEN. Thank you.

Thank you, Mr. Chairman.

Chairman BEREUTER. Thank you very much. That is an interesting idea.

The gentleman from California, Mr. Ose, is recognized.

Mr. OSE. Thank you, Mr. Chairman.

Mr. Miramontes, as I look at the list of panelists and their resumes, I suspect you are the one I should ask this question of. What is the total lending capacity for NADBank?

Mr. MIRAMONTES. Well, that is the number that I used at the beginning. The total lending capacity originally is $3 billion. Now that is because there is pending capital that represents about 15 percent, and 85 percent is callable capital.

The total lending limit is only doable is the loans you make are loans that will be repaid. Otherwise, the callable capital is at risk and you cannot use it. So practically the current lending capability of the NADBank, given its current structure is very low.

Mr. OSE. Because the nature of the loans are?

Mr. MIRAMONTES. The nature of the loans are not bankable in the sectors that it is focused on.

Mr. OSE. Right.

Mr. MIRAMONTES. The environmental sectors, I know of no State that can do that.

Mr. OSE. All right, I am looking at a piece of paper here that has a list of 43 loans that NADBank has made, totaling just under $1.15 billion. No, that is not quite right. The total project cost is just under $1.15 billion, and a loan amount of just over $23.5 billion. Now the Bank was established pursuant to NAFTA in 1994?

Mr. MIRAMONTES. Yes sir.

Mr. OSE. And you were the first employee.

Mr. MIRAMONTES. Yes, sir.

Mr. OSE. If I understand correctly, I mean, startups are not always good the first day, but maybe the first week or the first month. How long was it before you made your first loan?

Mr. MIRAMONTES. I cannot remember exactly, but it was 1996.

Mr. OSE. So it has been a couple of years to get tooled up to make the first loan, and then roughly a loan every month-and-a-half since.

Mr. MIRAMONTES. The answer is, yes, there has been a lot of activity on the border environment infrastructure fund. That is a grant fund, funded by EPA.

Now all of the grants that we do typically are blended. All the funding that the Bank does is a blend of loan and grant.

Mr. OSE. Right.

Mr. MIRAMONTES. The majority of those projects on that list have received loans from other sources: SRF funds and tax exempt sources of lending. So there has been a lot of activity, but the amount of loans is very, very small; seven percent of the total activity of the Bank and a fraction of the total project value.

Mr. OSE. Let me ask a question this way. Under your tenure, the total amount of loans from NADBank for, and I do not know how to describe this, other than perhaps use your words, the environmental projects that are less than bankable, the total amount of loans committed to that direction have been, is it $23.5 million?

Mr. MIRAMONTES. Million, yes, sir.

Mr. OSE. And the total amount of loans for the more commercially oriented or the bankable sector has been what?

Mr. MIRAMONTES. Well, currently, the bank does not have the ability to lend, or the only sector it can lend to is water, waste water, and solid waste.

Mr. OSE. And that was your point about the Charter?

Mr. MIRAMONTES. Yes, sir.

Mr. OSE. OK, I was just trying to make sure I got that. Now I also have a map here, for those of us who are graphically challenged, is pretty good.

But the description of this, if I understand the Charter, is that north of the border and south of the border, NADBank can make loans within 100 kilometers of the border. Yet, this map is not a straight line. It kind of jig-jags around here on both the north side and the south side. I do not quite understand that.

Mr. MIRAMONTES. I believe that is just the counties in the border. That does not depict 100 kilometers.

Mr. OSE. So it marks the eligible counties in toto, rather than the exact 100 kilometer line.

Mr. MIRAMONTES. Exactly.

Mr. OSE. Now I am just trying to examine a couple of these things. The loan limits of $4 million and $8 million, I think all four of you testified, and particularly Mr. Gonzalez, that given the size of the projects involved, that the $4 million and $8 million limit cause considerable discomfort, in the sense that you cannot really do the project under those limits. Am I understanding your testimony correctly?

Mr. MIRAMONTES. That is correct.

Mr. OSE. All right, and then you talked about the blended rate between either the grant and the loan, or the grant and the commercial loan, that it was still not basically competitive; or at least giving a cost basis low enough so that the community involved could actually afford to service the debt. Does that summarize your testimony?

Mr. MIRAMONTES. That is it, exactly.

Mr. OSE. Thank you, Mr. Chairman.

Chairman BEREUTER. Thank you, Mr. Ose.

Among others leading in this area, Mr. Gonzalez is probably the person that asked the most aggressively and appropriately that we proceed with this hearing, and I appreciate his initiative, and I recognize him.

Mr. GONZALEZ. Mr. Chairman, thank you, and my personal thanks for conducting the hearing. It is obviously a very important issue, not just to San Antonio and the border, but really for the entire United States, when you take into consideration the trading partnership that we have with Mexico. I want to make that distinction at the outset.

Also, in the interests of full disclosure, NADBank is headquartered in my district, and that makes it even more important. But even if NADBank was not headquartered in my district, which I trust that it will be, it is still a very important instrument for economic growth.

I appreciate the Chairman's comments that even if we go over the 5 minutes, we will be re-visiting. Because I would like to get the lay of the land, more or less, and make some observations, so that I am accurate, from the basis from which I am operating.

With the inception of NADBank, and Mr. Miramontes, obviously, you were there at the very beginning of it, but my understanding is, by its restrictions as to what projects you could actually lend money to, coupled with the terms of the loan pretty well made the bank ineffective, because you could not service those communities that required that kind of assistance.

Recognizing that, though, and under your watch, I believe you were responsible for making the Bank so very relevant to the economic growth of all these communities, by incorporating the BECC, and bringing in the EPA funding, and then becoming, of course, very relevant in that regard.

Yet, I know that you are always striving, in your own right, as NADBank, in its lending capacity, as a lender, as a bank, to be able to fill your responsibilities more completely, but your hands were basically tied.

So we fast forward, and we are here today. My concern is as follows. If you look at how we have entitled today's hearing, it is proposed changes to both the World Bank, International Development Association, and the North American Development Bank. My fear, of course, is that what we were discussing with the panel previous to yours spills over, and the thinking is the same: one size fits all; even though NADBank, its relationship, its goals, and its purpose are totally different than what we were discussing as far as World Bank and the IDA. That is my fear.

And the reason for that fear is that I believe that Treasury may be operating under that particular philosophy. That is, a grant mentality and philosophy, which has an appropriate place and application, versus loan which, again, in its proper environment, makes more sense; which I would argue NADBank comes under the latter.

That is basically, you know, my little world of NADBank that I operate out of. That is why I have introduced the Resolution, and for my colleagues that have joined me, I appreciate their support.

So that is where we find ourselves today. We are making a case for NADBank to expands its mandate, and allow realistic lending terms, so it does get involved and fulfill truly its purpose; that which was envisioned many years ago, when my father and others were here, when Congressman Esteban Torres were all here. You may remember the discussions back then.

So my question to you, and I think to Mr. Miramontes, and to Mr. Gonzales, do you agree with me, first of all, that we cannot have this one size fits all in today's hearing, in today's context, or otherwise; that Treasury needs to look specifically as to what is specific and unique to NADBank, the needs of the border communities; and not necessarily apply the same philosophy that Secretary O'Neill appears to be applying when the World Bank and its leaders and others have been meeting about debt forgiveness and so on.

So that would be my first question, Mr. Miramontes and Mr. Gonzales.

Mr. MIRAMONTES. I agree that the North American Development Bank serves a very distinct purpose, totally different from the other very large development banks.

I believe because of its focus, the border region is a better model for a development bank. That is a personal bias. I come from the border. I was at the Bank. But I believe because it is focused on a region, it can become an expert at that region.

What I do no agree with is that within that region, it should be limited to certain activities. I think the Board of Directors has the ability to determine, as time goes on, what is important to that region.

I grew up in El Paso more years ago than I want to think now, a few years ago. I have been to every community on the border, more than once, every one of them.

Every community has a distinctive set of differences. There is 3,000 miles from Brownsville to San Diego. You have one of the richest, most vibrant communities in San Diego. The poorest communities in the United States are on the border.

So the Bank has to become an expert. So I am going to argue that yes, being a one size fits all does not work and I will leave it at that.

Mr. GONZALES. I agree completely. I think the ability to focus the energies and efforts to this particular region is so critical that when you look at the people in the region, they are very hard working, very diligent people that have no problem paying their own way.

But if their own way is limited from a financial perspective, that debt capacity that could be placed on them would burden them beyond their limits. From a purely financial standpoint, and we talk about bankability, their ability to repay those loans has to be within the certain economic conditions that they have to live within.

For us to necessarily make some blanket statements would not be correct. The ability to focus in on this region, I think, is critical. Their ability to pay back loans is there, so long as they are affordable and sustainable. But both have to be considered hand-in-hand.

Chairman BEREUTER. Thank you. We will come back to you, Mr. Gonzalez.

Mr. Hinojosa, you are recognized for 5 minutes.

Mr. HINOJOSA. Thank you, Mr. Chairman. I would like to request that the introduction that I had of my friend Ernesto Silva from my home town of Mercedes be made a part of the record.

Chairman BEREUTER. Without objection, that will be the order.

[The referenced material can be found on page 55 in the appendix.]

Mr. HINOJOSA. I was very pleased to read a lot of the material that was given to us on the subcommittee, and pleased that Mayor Aranda has a regional project that is serving lots of communities in and around your home town.

I was also pleased to hear the way in which Mr. Ernesto Silva took that very high interest rate of nine percent on the original First Net Bank loan to the city of Mercedes and refinanced it with bonds at four and-a-half percent.

So I guess that was probably one of the biggest criticisms that I remember hearing about NADBank not being able to move faster and a lot more projects, as was stated earlier.

My question is first going to be addressed to Mr. Ernesto Silva, and then I would ask Mayor Aranda if he would also answer it. What are the needs of your community with regard to economic development projects where NADBank could assist you in carrying them out?

Mr. SILVA. Thank you, Congressman; first of all, let me say that infrastructure is economic development. Whenever a community is able to extend their infrastructure out to areas that are undeveloped, it allows for businesses to be able to locate and utilize those facilities to come into our communities.

So although we say that the Bank's role needs to be expanded for economic development, infrastructure already is economic development. It is a tool that we use for economic development.

However, once you have the infrastructure in place, how do you get those industries to come into your community? This is where the Bank could lend us a helping hand with low interest loans, specifically for certain industries; to allow us to be able to expand our industrial parks, for example; provide facilities that will support those industrial parks; provide loans for working capital for these industries.

These are all projects that could assist our local communities. When you take a look at the area along the border we have to understand that first of all, these projects that we keep talking about financing through the Bank, for the most part are not financially feasible for the communities; nor are they financially sustainable by the communities.

Therefore, we look for the Bank's assistance, so that we can be able to first develop the projects and then pay for them. If the city's capital is tied to these infrastructural projects, we do not have the capital to invest to bring in the industries. It is one or the other.

When you have people that do not have the infrastructure, or are not drinking clean water, then you are going to put your money into your infrastructural projects for clean water, instead of bringing in economic development in new industries.

What we need is for the Bank's role to be expanded into the health care, transportation, international bridges, international trade corridors, housing, for example. I would say that those are the areas that the Bank could assist the local communities in, to bring in economic development to, for example, Mercedes, Texas.

Mr. HINOJOSA. Thank you, Mr. Silva.

What about you, Mayor?

Mr. ARANDA. Mr. Hinojosa, I had not even thought of the possibilities of the NADBank being able to help out in that area. That is just because of a frame of mind.

But as you asked the question and I thought about it, if you take a look at Eagle Pass, just like the rest of the border region, I think our biggest challenge is adult education and work force development, to be able to have that economic development impact.

If the NADBank could help in that area, it would certainly be in areas of higher education and vocational education, and being able to work with the community colleges in our region that are always very strapped for funds.

The purpose our of our meeting here would be for water and sewer, and basic needs that are being addressed by the NADBank at this point. Before we get to that point that we are talking about economic developments, of course, we need to take care of those needs.

When you take a look at the city of Eagle Pass' needs, as far as water treatment plant, we really could not grow very much, having a plant that is at almost 90 percent capacity.

But looking beyond that, I would probably go back and say that the most important thing for our region would be the education of our adults.

Mr. HINOJOSA. So if I hear you correctly, you would support then the discussion that President Fox and President Bush had recently, in consideration of expanding mission statement of NADBank?

Mr. ARANDA. Well, I guess if I go back to the first way I answered your question, there are so many basic needs that have not been taken care of yet, that I would not support something of that sort, yet.

If there would be funds to be able to take care of the needs that we currently have under infrastructure, then I would go to that next step.

Mr. HINOJOSA. I am going to have to wait until the next round to continue this discussion, because I would like to hear from Mr. Miramontes about expanding the mission statement, and then the problems that he foresees when they join the two groups of NADBank and BECC.

Thank you, Mr. Chairman.

Chairman BEREUTER. Thank you, Mr. Hinojosa.

I think, Mr. Hinojosa, that I may actually get into that in my own round of questions a little bit, but we will pursue it.

Mr. Miramontes, since you were around at the creation, and all of you were probably watching it, NADBank can finance the waste water treatment, drinking water, disposal of municipal waste, or at least they can provide resources for it.

My first question is, why was it limited? In your judgment, what is the history on that sort of environmental spectrum of the infrastructure?

Mr. MIRAMONTES. I actually was not involved in the negotiations during the NAFTA process. I actually came on board after the NAFTA was passed. But basically, the general fear was, if you were to have a major trade agreement, that would just open wide the trade routes Mexico and the United States.

The pressure was already there, and that the environment would suffer the most through increased traffic, increased air pollution. Waste water needs, at that point back then, were in terrible shape. So they were high priorities.

So I think the focus, and I agree with Mayor Aranda, the original focus of health and well being, the fundamentals must be the first job of the Bank. There is no question about that.

But jobs, in my mind, have always been the greatest source of environmental security. For people who are poor with no jobs, the environment is secondary. For people with a home in a community that they take pride in, and they have a job, the environment is important.

Chairman BEREUTER. Thank you, I would like to say that while I recognize that in all probability, you would like to broaden this to a whole range of infrastructure and services and assistance, and that is quite understandable, I would like to ask each of you just to go right down the line as to what would be the next vital elements of assistance that you would suggest?

If we did not have the ability to move it throughout, I want to have some idea of priorities, and any kind of cautionary notes that you might have. So let us start at that end, Mr. Gonzales, first, and we will work back.

Mr. GONZALES. I think that is a great question. I had put some written testimony together to hopefully go toward that end.

In expanding the range, say, from the 100 kilometers to the 300 kilometers, and various types of infrastructure projects, if that were to be accomplished to keep the staffs of the BECC and the NADBank focused on the 100 kilometer area, use outside consultants, the private sector, for those entities that want to come in and utilize the NADBank's resources for lending within that 100 to 300 kilometer range; use private sector resources to get that accomplished.

Focus the staff and the energies of the Bank on the 100 kilometer region, with the anticipated benefit of more market rate interest rates lending in that 100 to 300 kilometer region. That money would actually be going back into the 100 kilometer region. I think that is the area that I would recommend.

Chairman BEREUTER. All right, thank you.

Mr. Silva.

Mr. SILVA. If I understood correctly, you want to know what areas to expand into?

Chairman BEREUTER. What are your top priorities?

Mr. SILVA. I would say transportation, the funding of international trade corridors, and also international bridge crossings. That is the thrust of NAFTA trade, and I think that was pushed aside.

Chairman BEREUTER. Thank you.

Mayor Aranda.

Mr. ARANDA. Mr. Chairman, I will go back to the statement of Mr. Hinojosa. It would be in the adult education and work force development area.

Chairman BEREUTER. All right, very good; Mr. Miramontes?

Mr. MIRAMONTES. It would probably be transportation-related activities.

Chairman BEREUTER. Thank you very much, and we will just wait for another question, and go back to Mr. Bentsen for our next round.

Mr. BENTSEN. Thank you, Mr. Chairman.

On the expansion, I have to say, it does concern me a little bit, and I think this is what Mr. Aranda was saying. I think you need to get the first part done right, and then look at moving beyond that.

There is a little bit of a corollary between the debt forgiveness, even though I understand what Charlie is saying, in that part of the concept behind debt forgiveness, when we passed that, was to free up countries to be able to use resources that were otherwise going for debt service to put into human development, whether it be education or health care or whatever. I think the same would be true here.

Let me get back to what you are funding now. I look at all the projects and the demand that is there; what has been funded either through loans or primarily through grants, sewer and water, waste water, and solid waste.

A good part of this, as Mr. Aranda and Mr. Silva pointed out, has been funded under the State revolving loan program, either through them buying the bonds or however it works now.

But obviously, the demand or your capital need is greater than what the State program allows for. Otherwise, I guess they would take down the whole project, if I understand that, and Mr. Gonzalez probably understands how the project works far better than I do.

So if we get back to what I think the idea was behind NADBank, it was to fund an additional public good that is not already being funded under the 1987 Clean Water Act that allowed for the creation of the SRF.

Is that accurate, or is the State not coming through with sufficient funding for these projects? Because if that is the case, again, I think it goes back to the idea, and I understand, Mr. Miramontes, as you go to Treasury, I mean, my opinion has always been that the tax staff at Treasury, the first thing they say about tax exempt bonds is that they are unconstitutional; they do not like them, and they ought to all be repealed. But once you can get past that point, then you can maybe get something done.

I think your testimony is right on target, in that you are priced out of the market, as long as there is a tax exempt function, even though you have credits, because of their situation, where they are along the border; if, in fact, they have maxed out on what is already provided under the SRF, I mean, they are caught in a catch-22.

Mr. SILVA. Well, there are two reasons why someone would not go through the SRF. First, depending upon when the bonds were sold by the State, that determines the interest rate. If they were sold prior to the interest rates coming down, then the interest rate at the State is even higher than the NADBank.

Second of all, it would be the amount of red tape that is required to go through a loan through the SRF and the State. It is much quicker to go through the NADBank or sell tax exempt bonds in the open market, than it is to go through the State.

A prime example is the city of Mercedes. We took a different route. The interest rate was too high. With the amount of work that it takes to get the loans from the SRF, it would be easier to go to the NADBank, and even eventually go out into the open market and sell tax exempt bonds. That is from Mercedes' perspective.

Mr. ARANDA. Mr. Bentsen, for the city of Eagle Pass project, the State has put together a total of $50 million out of the $103 million; which, in my opinion, would be a great amount of money that would be based on grants. The rest of it is based on the loans directly from the Textile Water Board. It is based on the revolving fund, and also the community development block grants.

So I think I would pass that on to Mr. Gonzales to be able to answer the question of whether that would be sufficient or not.

Mr. GONZALES. The ability to fill the gap that the State agencies, for example, cannot current fill, in some programs, for example,they can lend you money for your project that will take you up to the property owners property line and no further.

The NADBank comes in with grants and is able to complete the project from the line that runs in front of the house to the house, the hook-ups. So there has been different pieces that different agencies have been able to fill, in order to complete the project and maybe somehow trying to look in a more comprehensive scope.

With the NADBank hopefully coming across with more grant assistance, it can fill more of the gap that cannot be filled in other areas. Because from a pure lending perspective, under their current constraints, they are not going to be in a position to do that.

Mr. BENTSEN. My time is up, and Mr. Miramontes may have a comment. But if you can lend at even tax exempt rates, you are going to extend the use of that capital much longer than if you grant it out. It will be gone.

Mr. MIRAMONTES. Should I respond?

Chairman BEREUTER. Yes, please respond.

Mr. MIRAMONTES. When it became clear that the Bank was not going to be able to lend large amounts of money, I remember sitting around thinking, OK, now what do we do?

I decided that what was needed was two or three things. One was really investment banking services. There are 10 States on the border, with 10 different sets of rules. The Mayor has five other jobs to do every day in Eagle Pass, and all of them are just as important as this.

So it was imperative that we help those communities understand how to access money that was already there. That is number one.

Number two, the communities themselves needed help. Mr. Silva mentioned all the money that we gave back then. That was community development. That was institutional development. That allowed them to go to the market place. They could not access the market before that. So that is very important.

The Bank strived to serve and tried to make up for its lack of lending abilities with service. This is the second point I would like to make, real quick. I am not advocating for expanding the Bank's current activities. I think it should be done very prudently.

I am arguing for the reform of the Charter to allow it to occur, when appropriate, by the Board of Directors. But I do not think it should expand its activities much right now.

Chairman BEREUTER. Thank you.

Mr. Gonzalez is recognized.

Mr. GONZALEZ. Thank you, Mr. Chairman.

Again, you know, I will preface with this my own observation here, because I know there are concerns that if the mandate is expanded, if we change the terms of the loans, while that is a good thing, because it is in a banking environment, and it means you leverage funds. You have monies coming back out. You make more loans. You improve the lot for many other people than if it was in grant form.

The concern is, of course, that you would neglect the environmental concerns in projects that these communities that need to be addressed, and you are a part of that.

But I am also familiar with a study that was performed, and let me get the names of everybody that was involved, because I think it was a very good study, and has formed the basis for much of what we discuss here today.

That was with Texas Center for Policy Studies, the Willie C. Velasquez Institute, the Center for Strategic and International Studies, and the National Wildlife Foundation, which brought all stakeholders, all interested parties, diverse interests, and they all agreed that you could expand the mandate, you could change the terms of loans, you could do things with the capital, because they realized the importance of the character of a bank and what that means, as opposed to purely grants, while still not neglecting or diminishing in any way the obligations, in grant form and otherwise, on the environmental projects.

So I know that it can be doable, and I know what Mr. Miramontes is saying; you do it prudently and slowly. So that is the first concern.

Anything that you suggest here today, either Mr. Gonzales or Mr. Miramontes, does it jeopardize or diminish what need to be done on the environmental infrastructure that we have out there and the problems that we have.

Second, the other concern that I have heard expressed is, you do not really want NADBank basically taking business away from the private sector. So is there a niche out there for them that does not impact something that might be available to communities through the private sector. That is more for Mr. Gonzales.

But the first question is basically, you know for both of you. Do you see any threat to the environmental side of this whole issue? Then the second question is to Mr. Gonzales about the impact on the private sector.

Mr. GONZALES. With respect to the diminished on the environmental perspective, I do not think that there would be any. I think there is such a heightened awareness already that exists that there is going to be so many people, particularly in the NGO community, that are going to be focused on what is going to be going on, that that is not going to happen.

With respect to the private sector, I think probably more than anything else, there is going to be a greater ability to work with the private sector, and hopefully accelerate projects with the private sector, and not necessarily be seen as competition.

One of the things that they will obviously realize is that if they are dealing with the NADBank, there is still going to be a lot of due diligence and analysis that is going to be done. If they have the resources and are able to do it without the NADBank, then they probably will not utilize them, and go their own way of either acquiring or providing their own investment for moving forward on their particular projects.

So I think it is probably going to be, when the transportation issue was mentioned, for example, I think that is probably a good blending of public/private opportunity to create greater enhancement in a shorter period of time.

Mr. MIRAMONTES. I concur with what he just said on both points. I think the issue that a subcommittee like this has to concern itself on policy is the issue of additionality. A development bank should not step in the place of the private sector. It should not get in the way of the private sector.

I truly believe though that, given the dynamic nature of the border, the border regions are a wonderful economic zone. It is one of the most capitalistic places on earth, where people are making a living on street corners, and eventually become store owners, and eventually become owners of chains. I have seen it happen in different places along the border.

What you need is a mechanism to induce the private sector capital to do deals that sometimes they may not be willing to do for different reasons. That is a case-by-case factor. But the role of a development bank should be very specifically limited to how do you help create that economic structure where the private sector is willing to take the risk, as appropriate?

Mr. GONZALEZ. Mr. Bentsen was here whispering in my ear about microloans. So will I yield back whatever I have left here, in a very short period of time.

But again, in the area of microloans, because I know we are talking about certain transportation projects and others, is there a whole other area for NADBank, should the mandate be expanded prudently and piecemeal, according to policy, Board of Directors, and input.

Mr. MIRAMONTES. On that issue, when we talk about transportation, we all think of highways and bridges and all kinds of big things. I think of transportation-related air quality.

My home town of El Paso, Texas, I cannot move back to because I am asthmatic, and the air quality in El Paso is one of the worst anywhere in the United States, if not the worst. One program that was being proposed in Huades was for a series of smog emission check points being funded with microloans. That is an example of something that the private sector probably will not do.

But will make a difference in air quality and transportation in Huades? Definitely, it will. Will it help the people in El Paso? I know it will.

Chairman BEREUTER. Thank you; the gentleman's time has expired.

The gentleman from California, Mr. Ose, is recognized.

Mr. OSE. Thank you, Mr. Chairman.

I regret missing most of the questions of the gentleman from Texas. Let me start at the 35,000 foot level. If the Charter of the

Bank was significantly expanded, in other words, limitations on waste water and drinkable water and what have you, were lifted, what is the likely size of the market, if you will, that NADBank could invest in? I mean, is it so large as to be unquantifiable, Mr. Miramontes?

Mr. MIRAMONTES. If you look at the infrastructure needs, just in water/waste water, over the next 5 to 10 years, I believe it is $2 billion or $3 billion, just water/waste water.

If you take transportation, energy, pipelines, you are probably in the range of $20 billion or $25 billion of needs along the border. It is going to double in size.

Should the Bank do all that? Of course, they should not. It makes a difference, yes. But we are talking about billions of dollars of needs. That is why you need to have mechanisms that deal in billions, not in millions.

Mr. OSE. All right, if we were to take the waste water, drinkable water, storm water, and solid waste issues off the Charter, in terms of their exclusivity, what would be the fourth thing, then? If the first three are waste water, drinkable water, and solid waste, what is the fourth thing? I would be interested in what the local officials have to say about that, too; Mr. Mayor?

Mr. ARANDA. Mr. Ose, we answered that question earlier, but we will go ahead and do it, again.

Mr. OSE. I appreciate it, thank you.

Mr. ARANDA. There was a difference of opinions. We all have a different way of looking at our economic development regions. In my personal opinion, I think the biggest need for the Texas border is in the area of adult education and work force development.

That, in my opinion, would probably be the biggest economic impact that the border will ever show, when you are talking about the poverty level and the education level of our region, and why we are the way we are. I apologize for pointing that out.

Mr. OSE. All right, Mr. Silva.

Mr. SILVA. Yes, it was international cross and international trade corridors.

Mr. OSE. Mr. Gonzales, any input?

Mr. GONZALES. Yes, I probably did not do a very good job of answering that question specifically last time. But I would say transportation. In general, those projects have such far reaching benefits from an environmental and economic perspective to add, just in general, more value to those communities.

Mr. OSE. Well, the question of the trade crossings particularly intrigues me, because I have been to El Paso and some of the other border crossing points. You see the cars and trucks lined up on one side of the border or the other, depending on the time of day and what have you, just as far as the eye can see.

We would have to, if I understand the procedure correctly, change the current Charter to allow NADBank to provide assistance for the construction of a larger processing point or transit point. Is that correct?

Mr. SILVA. Well, there are several steps. First would be the financing of the actual studies, the environmental and feasibility studies. I think that is more important, because that would impact the environment.

We would be able to provide a pro-active approach, instead of reactive, once the bridge is open and you have the problem. We would be able to resolve some of those issues prior to the construction of these facilities.

Mr. OSE. Mr. Mayor, on the work force development stuff, it is interesting. My father was the only member of his family to go to college, and he is the only one who left the farm. My mother was one of nine, eight of whom went to college, two of whom stayed in their original community; but all of whom went into entrepreneurial efforts.

How could you connect the dots on NADBank involvement on work force development in such a way as to quantify the direct impact?

Mr. ARANDA. Most of that education that I am talking about would be done by the community colleges in the area. These are community colleges that are funded through local property taxes, and those property taxes are already at a low number. So when these community colleges are looking into new curriculum, the concern that exists is that they do not have the money to invest, to be able to do it for the first 3 years. After the first 3 years, the State of Texas reimburses them, based on the amount of contact hours.

So to start off new programs, the funding could come from NADBank, and it is a matter of a low interest loan, or also available grants for that purpose.

Mr. OSE. All right, thank you, Mr. Chairman.

Chairman BEREUTER. Thank you, Mr. Ose.

Now Mr. Hinojosa is recognized.

Mr. HINOJOSA. Thank you, Chairman Bereuter.

I want to say that in February of 2001, when a group of Senators and Congressmen met in Mexico City with President Vincente Fox, he talked about expanding the mission statement. I agreed with you, Mr. Miramontes, that we needed to first show that we could do the original mission statement, before expanding it, and I was in disagreement.

It is interesting that in just a year after that discussion, I have to agree that if the NADBank mission statement has not been implemented, that maybe we need to make some changes, and not wait until, like you said, it was practically feasible and financially feasible, and so forth. I think that we really need to make the changes.

I have to agree with the Mayor and with the City Manager that the projects of transportation and education and job training are the things that are going to change the Southwest Mexico/United States border region.

It is interesting for me, as a new Congressman here only 6 years, that when we try to get monies for transportation for an area like ours, that 2,000 mile border, that we cannot possible get it, simply because Maryland and Virginia and New York and all the big MSAs manage to get it by the billions of dollars; and so crumbs are given then to regions like ours, that have been neglected for 30 or 50 years.

If it is to happen, if we are to make the Mexico/United States border look like those big MSAs of Houston and Dallas, we have got to have the money for the infrastructure. I think that NADBank is just as good a source to access the kinds of monies that you need to be able to improve economic development in those areas, lowering the unemployment rate which, like in the example of my region, Hidalgo County, it was 21 percent 6 years ago.

With all the growth and improvements and monies that have been injected here these last 5 years, we are still at 10.5 percent; twice that of the State.

So I have to agree that it is time for this subcommittee and others in Congress to take a look at putting in enough money, $2 billion, $3 billion, $4 billion, $5 billion, into the NADBank, expanding the mission statement, and doing what some of you are recommending. Because otherwise, it is not going to happen. If we have to be in line to get money from the Department of Transportation, it will be another 50 years. It will never happen in our lifetime, that we would see the roads in the condition that they need to be, to take care of all of the thousands and thousands of trucks that Congressman Ose was just mentioning a moment ago in El Paso, Laredo, Farr, Brownsville.

We need to answer something that we did not think of, and that was that to bring trucks through our borders, you have got to have the highways to be able to handle those 18 wheelers. that was not accounted for. That was not planned for, and they certainly did not earmark the money to do that.

So it has been informative, and I thank you members of the panel for coming and making us aware of the importance of really having a debate amongst ourselves to see if indeed we should expand the mission statement and, indeed, put in some money like Vincente Fox and President Bush talked about doing, so that we could carry out some of those projects.

I do not want to ask any more questions, because the time is running out. But I, again, thank each and every one of you for bringing us your perspective, and empowering us with that kind of information, so that we can do a better job with NADBank and the BECC group.

Thank you very much.

Chairman BEREUTER. Thank you, Mr. Hinojosa.

I have one more question. It really relates to the proposal of the two Presidents about merging the boards between the NADBank and the BECC.

I wonder if any of you could give me a specific example. Generally, I heard one of you, at least, sort of duck this issue, as that is something that you have to consider.

But I wonder if you could give us any examples where the existence of two separate Boards of Directors acted in an efficient fashion or created problems; or examples whereby one board would have been more effective, to put it in a positive way?

Mr. SILVA. Well, I am not going to sidestep it.

Chairman BEREUTER. Go right ahead.

Mr. SILVA. I would say, not to merge the boards would probably be my recommendation. You have a check and balance here, where the NADBank does the financing for projects that BECC reviews for their engineering value.

Also, you have the ability for the NADBank to provide grants for institutional development for these communities. These, in essence, are the basis for the BECC to approve or disapprove, or what they call certify or not certify a project. It provides the basis for the projects to be financially feasible and self-sustaining.

If you merge them, I believe there is going to be a lot of pressure put on these boards, or this one board, to approve projects that are not self-sustaining or financially feasible.

Chairman BEREUTER. To the extent that you are familiar with the people that serve on the two boards, is there some movement, or does it already exist, a specialization, in terms of expertise that they bring? Does the Border Environmental Cooperation Commission reflect a particular expertise that may not be in the Bank, and vice versa?

Mr. SILVA. I believe so. I believe the expertise in the BECC is more on the project and engineering development; and the Bank has more of a financial expertise, and it should be that way.

Chairman BEREUTER. Does anybody else want to venture a comment about inefficiencies you have seen or problems or positive items?

Mr. MIRAMONTES. Mr. Chairman, since I am no longer employed by the Bank, I guess I can comment as freely as I wish. I want say that the two boards have done a good job. It has been rough, at times. But I think a single board with a focus is useful. Because the conflicts would come in terms of where policies were not identified.

One of the first problems initially, which was resolved, but with a lot of discussion, initially the BECC process was giving greater hopes to communities of grant funding that was possible by the Bank. The Bank would then come in later and have to be the bad guys and say, no, you cannot get that much money.

That has been pretty much the result. But that is an example of where when you have two different missions, it can cause problems.

I think merging the boards does not solve the Bank's problems, though. I think merging the board makes the institutions possible more efficient, with a single focus with one accountable board. But it will not make more loans show up, because of the fundamental problems we discussed earlier.

Chairman BEREUTER. Are there any other comments from the panel; Mr. Gonzales?

Mr. GONZALES. To not side step the issue, as mentioned before, merging the two, I think, as Mr. Miramontes said, is not necessarily going to bring about more loans. If you are trying to bring about a greater sense of efficiency and cohesiveness, in terms of policy directive, I think you could achieve some economies of scale.

But I think the key is that there still has to be a greater emphasis on the financial perspective; not to diminish the environmental aspects of it. But the reality is that the financial aspects of these projects, in order for them to succeed, is going to be based on the finances and not on the environmental aspects.

If that aspect of the board is diminished, then I would have some significant concerns. So long as that is maintained, then I would say merging the boards would probably not have a negative effect, assuming it is done in a judicious manner.

Chairman BEREUTER. Thank you.

Mr. Miramontes, do you wish to weigh in on this subject?

Mr. MIRAMONTES. Mr. Chairman, I would support the merging of the boards, and that goes back to business sense. Having one board would probably be more efficient.

We did not experience any differently in working with the BECC Board and NADBank. But if you had one board, it certainly would make things a lot better.

Chairman BEREUTER. Thank you very much.

I would turn to the Texas delegation here, since we are well represented, and see if there are any final questions or summary comments or anything. Mr. Gonzalez?

Mr. GONZALEZ. Yes, Mr. Chairman, again, thank you for calling this very important hearing, and putting up with so many Texans. I know it is not an easy chore, at times.

I want to thank each and every one of the panel members. It was short notice and you made it, and thank you for, as Congressman Hinojosa pointed out, enlightening us and it is very important.

It is only important if, in fact, we have some input as to what is going to happen to NADBank, which has not been forthcoming in dealing with Treasury.

Mr. Chairman, this is something I was going to bring up to your attention later in a private meeting. But despite repeated requests to Treasury for certain information, some of which on the record was promised to me, it has never materialized.

We have just not received anything in writing, after requests and requests at different levels, to the highest levels. This leads me to believe that they will be moving forward without any input from Congress, without any of our concerns being addressed.

I know that negotiation would be nice. Eventually, this Congress will be passing on whatever changes they desire, as well as the Congress in Mexico, which has already gone on record as disapproving some of the suggested changes.

I would like to see a better relationship. I do not know what I have to do. Obviously, in my own capacity, I have not been that successful. So I was going to enlist the leadership from both sides of this subcommittee. Because today, it might be Charlie Gonzalez and NADBank, and tomorrow, it may be another Member, and another issue of great importance to that particular Member.

Again, thank you very much, Mr. Chairman.

Chairman BEREUTER. Mr. Gonzalez, I understand your concern. If Mr. Sanders and I could be helpful by writing a joint request, which elaborates the concerns and issues and items that you are seeking, I think we can certainly do that. We may be able to enlist Mr. LaFalce and Mr. Oxley, as well. Thank you.

I want to reiterate the appreciation that Mr. Gonzalez and others have mentioned about your appearance on short notice for this important hearing. I know it was a special effort on your part. I very much appreciate it. We are going to try to make good use of the information that you have given us.

I know that the alumnus of this committee, former Congressman Esteban Torres, is very interested in the progress of the NADBank.

I think it was a crucial item with the support of the late Chairman Gonzalez.

So we have a special interest in the Banking Committee, which is now turned into the Financial Services Committee, in making sure the NADBank functions well.

Thank you very much. The hearing is adjourned.

[Whereupon, at 12:27 p.m., the hearing was adjourned.]

A P P E N D I X

May 2, 2002

Opening Statement
Subcommittee Hearing on World Bank-IDA Loans to Grants and the North American Development Bank
May 2, 2002

The Subcommittee on International Monetary Policy and Trade meets today in open session to examine the following two different subjects: First, the General Accounting Office's (GAO) report on the Administration's proposal to convert World Bank loans to grants, and second, proposals to reform the North American Development Bank (NADBank). With respect to the NADBank, I would like to thank the following three Members of the House from Texas for their contributions to this important hearing: Mr. Gonzalez, Mr. Hinojosa, and Mr. Bonilla.

Loans to Grants

Regarding our first topic of discussion, that of the GAO report on the Administration's proposal, of converting loans to grants, it should be noted that in July 2001, President Bush proposed that the World Bank replace up to 50% of future lending to the world's poorest countries with grants. This proposal was motivated, at least in part, by concerns about poor countries' long-term debt burdens.

The President's loans-to-grants proposal has been controversial within the donor community, and indeed is at the heart of current negotiations which began yesterday and continue today in London over the terms involving contributions to the World Bank's International Development Association (IDA). The IDA is the World Bank's fund for highly concessional loans made to the world's poorest countries. As you may know, the IDA is slated for congressional reauthorization this year. However, as of yet, the Administration has not made a formal request for an IDA replenishment because the IDA negotiations generally have been stalled on the issue of whether a percentage of the loans made by the IDA should be made in the form of grants to the recipient countries. Many European donor countries are opposed to any grant-based proposals on the grounds that grants will be too costly to the IDA and would jeopardize the long term financing of the World Bank.

To address the issues that have been and will be raised during the London negotiations, Senator Jessie Helms and I co-requested a GAO study on the effect of the President's 50% loans-to-grants proposal. It is important to note that the GAO recently published their report on the subject. Therefore, today, we review findings of the GAO Report. The loans-to-grants issue is a complex one and only part of our calculation in considering U.S. financial commitments to the IDA.

NADBank

Furthermore, I would now like to briefly discuss the subject of our second panel -- the NADBank. Before introducing our witnesses, I will provide some background on the following three areas of the NADBank: history and functions, the proposal of President Bush and

President Vicente Fox of Mexico to reform the NADBank, and Rep. Gonzalez's legislation (H.Res. 355) on this subject.

First, regarding the history and functions of the NADBank, in October 1993, due to concern that the increase in economic activity resulting from the implementation of NAFTA would promote poor environmental conditions along both sides of the U.S.-Mexico border, the United States and Mexico agreed to the creation of a new institutional structure to promote the environmental health of the border region. As such, the Border Environment Cooperation Agreement established the NADBank and the Border Environment Cooperation Commission (BECC). These institutions work together to assist communities within 100 kilometers on either side of the U.S.-Mexico border by financing environmental infrastructure projects that address the need for wastewater treatment, drinking water, and disposal of municipal solid waste.

The BECC specifically would provide assistance to these communities to coordinate, design, and mobilize financing for these infrastructure projects. In addition, the BECC is to certify the projects. The NADBank determines the feasibility of BECC certified projects, and subsequently provides the appropriate funding. Since its inception, the BECC has certified 57 projects, with a total construction cost of $1.2 billion. The NADBank has committed Environmental Protection Agency grant funds to 37 of these projects. However, with respect to the performance of the NADBank generally, it is important to note that it has only approved $23.5 million in loans and disbursed only $11 million in project loans in its seven years of existence. Yet the NADBank does have $405 million in authorized paid-in capital and a lending capacity of $2.7 billion.

Second, with respect to proposals to reform the NADBank, Presidents Bush and Fox formed a bi-national working group that held a series of discussions with states, communities, and other stakeholders in the border region with the purpose of generating plans for reform to strengthen the performance of the NADBank and the BECC. As a result of these meetings, the two presidents came forth with a joint reform proposal.

One of the reforms would expand the jurisdiction of the NADBank and the BECC only in Mexico from 100 kilometers to 300 kilometers from the border. The jurisdiction of the NADBank and the BECC in the U.S. would remain unchanged under this proposal. Additional reforms would increase the capacity of the NADBank to provide grants and low-interest loans by doubling the low-interest rate lending facility to $100 million and establishing a $50 million grant financing allocation.

The presidents' proposal also would provide for a change in the organizational structure of the NADBank and the BECC through the creation of a single board of directors to oversee both institutions. The board would have representation from both countries' Federal Governments; the four U.S. border states of California, Arizona, New Mexico and Texas; as well as representatives from those border states in Mexico, and from the public.

In addition, the Subcommittee needs to begin examining H.Res. 355, which was introduced by Representative Gonzalez of Texas and which is cosponsored by 10 additional House Members. This resolution would offer alternative recommendations for reform to the

NADBank. While this resolution would allow the NADBank and BECC to remain separate entities, it would require a review and subsequent improvement of BECC's certification process. This resolution would also express the sense of the House that the boards of the BECC and the NADB should consult with interested parties in exploring options for better follow-up of projects. Additionally, Mr. Gonzalez's resolution, among other things, would allow the remaining paid in capital and callable capital to be lent without BECC certification for non-border and non-environmental infrastructure projects.

Therefore, to assist the Subcommittee in examining these issues, I am pleased that we have the opportunity to hear from our distinguished witnesses. In the first panel, we will hear testimony from Mr. Joseph Christoff, the Director of the General Accounting Office's International Affairs and Trade Team. Among the various areas under his direction at GAO is that of the multilateral financial institutions. Since Mr. Christoff joined GAO in 1980, he has worked in their offices in Washington, Chicago, and Frankfurt, Germany. He received a Master's Degree in Public Administration from American University, and a Bachelor's Degree in Public Policy from Miami University of Ohio.

With respect to the second panel, which will be testifying on the current status of the North American Development Bank, we will hear from the Honorable Victor Miramontes. Mr. Miramontes is currently the President and Chief Operating Officer of American City Vista, where his responsibilities include operations, finance and project development. Prior to this position, Mr. Miramontes served as Managing Director and Chief Executive Officer of the NADBank. He holds a Bachelors, and a Masters Degree in Economics from Stanford University, and a law degree from Stanford University as well.

In addition, the Honorable Jose A. Aranda, Jr., the Mayor of Eagle Pass, Texas, will testify on the second panel. Mayor Arranda was first elected in 1998 and is now serving in his second term. Eagle Pass is a border town which has interaction with the NADBank and the BECC. Mayor Arranda, who was suggested as a witness by Representative Bonilla from Texas, is also the Chairman of the Texas Border Infrastructure Coalition.

Further, we will hear from Mr. Ernesto Silva, the City Manager of Mercedes, Texas. Mr. Silva was suggested as a witness by Congressman Hinojosa of Texas. As City Manager, Mr. Silva has had direct involvement with the NADBank, coordinating in Mercedes a Water Treatment Plant Expansion, a Master Drainage & Paving Program and a Master Wastewater Interceptor Program. Mr. Silva began his work in Mercedes in 1997, after serving the previous 10 years in the City of Pharr, Texas, also as City Manager, coordinating similar infrastructure projects.

Lastly, Mr. Don Gonzalez will testify. Mr. Gonzalez, who was suggested as a witness by Rep. Charlie Gonzalez, is the Executive Vice President-Manager with the investment banking firm of Estrada Hinojosa & Co., based in San Antonio. He has direct experience working with border communities in obtaining financing from the NADBank.

Before the witnesses testify, I now turn to the distinguished gentleman from Vermont, the Ranking Member of the Subcommittee (Mr. Sanders) for any comments that he might have.

Statement of Congressman Charles A. Gonzalez
Hearing on NADBank
Thursday, May 2nd, 2002

I want to first thank Chairman Bereuter and Ranking Member Sanders for holding a hearing on the NADBank. By convening this distinguished panel, the Chairman and the Ranking Member are demonstrating their commitment to improving the quality of life along the US/Mexico border. I also wish to submit for the record comments from Congressmen Solomon Ortiz and Sylvester Reyes, Mayor Ed Garza of San Antonio, and from the Free Trade Alliance of San Antonio. All of whom are strong supporters of this institution.

Mr. Chairman, we face a serious infrastructure crisis on the U.S./Mexico border. The tremendous economic and population growth that has occurred since the passage of NAFTA has seriously strained the existing infrastructure and the local environment. It is estimated that if current patterns continue there will be almost a 100% increase in population on the U.S./Mexico border over the next twenty years--roughly 12 million new people. For decades the infrastructure needs of the border have been systematically neglected by both Washington and Mexico City. Now we must play catch-up fast.

Recognizing the challenges of a post-NAFTA world, President Clinton and the 103rd Congress created the North American Development Bank to help finance infrastructure projects along the border region. NADBank is the first and only development bank whose mission is exclusively the promotion of infrastructure development along the U.S./Mexico border.

NADBank provides loan and grant financing as well as technical assistance for the numerous border communities struggling with the infrastructure challenges of a post NAFTA world. It works in coordination with the Border Environmental Cooperation Commission, a unique institution that ensures that financed projects improve environmental quality. To date over 43 projects have been approved for financing by NADBank for a total value of approximately $1.14 billion.

Though NADBank has made important contributions to the welfare of U.S./Mexico border residents, it has struggled under its original mandate to live up to its full promise. NADBank's original mandate was in essence to provide conventional loan financing for water, wastewater and other related infrastructure projects on the border. Conventional loan financing for many small border communities is often un-workable, especially in the water infrastructure area. Many of these communities are extremely poor and can not as practical matter charge much for clean water.

Recognizing these challenges over the last couple years, NADBank's mandate has been expanded to include among other things air quality improvement, public transportation and water management. Also new grant and low interest loan programs have been created. These changes have been useful in further developing the bank's potential.

Last year, the Bush Administration and the Fox Administration began serious negotiations on how to improve the NADBank system. I commend Presidents Bush and Fox for making a commitment to border economic development. But, I have concerns with some of the proposals offered by Treasury as a result of these negotiations. Specifically, Treasury's proposal to more explicitly limit NADBank's mandate to environmental projects as well as to distribute a significant portion of its paid-in capital out in the form of grants, would in my view make it more difficult for the bank to fulfill its original goal of expanding the infrastructure financing opportunities of border communities.

In my opinion, we need to seriously discuss further expansion of NADBank's mandate to include infrastructure projects where more traditional loan and other financing options are more practical. Only when the full range of infrastructure project financing becomes available to NADBank will the original intention of Congress in creating the institution be met.

I also take issue with Treasury's proposal to merge the boards of the BECC and NADBank. I fear that this is a first step toward the merger of these institutions. Merging the BECC into NADBank would significantly undermine the environmental assessment element of this system.

Along these lines I have introduced legislation, H.Res. 355 that instructs the Treasury in its negotiations with the Fox Administration to continue the BECC/NADBank structure, and to open up NADBank's lending to all border infrastructure projects. Joining me in H.Res. 355 are among others, Congressmen Henry Bonilla, Lamar Smith, LaFalce, Menendez, Bentsen, Sandlin, Hinojosa, & Reyes.

I am also concerned by the apparent unresponsiveness of Treasury to inquiries from my office as well as other offices as to the ongoing status of its negotiations with the Mexicans. Discussions that will change an institution so important to millions of border residents should not be cloaked in secrecy.

Finally, it is my understanding that the Mexican Congress has expressed strong opposition to some of the proposals recently negotiated by Treasury. It is my sincere hope that Treasury does not attempt to move significant legislation regarding NADBank until it is clear that the probability of passage of similar legislation on the Mexican side is strong.

In summary, we have today an opportunity to discuss one of the most important institutions for long-term health of the U.S./Mexico border region. I look forward to the testimony of these expert panelists, each of whom has significant practical experience with NADBank. I thank you Chairman again for holding this hearing.

Congressman Rubén Hinojosa
Testimony and Ernesto Silva Introduction at NAD Bank Hearing
May 2, 2002

I want to thank Chairman Bereuter and Ranking Member Sanders for allowing me to participate in this hearing today, even though I am not a member of the Subcommittee on International Monetary Policy and Trade.

As the Congressman from the 15th District of Texas, which includes the U.S. / Mexico border region, my constituents are directly affected by the work of the North American Development Bank and are vitally interested in reforms that will improve the bank.

Unfortunately, despite large amounts of available capital, the Bank has funded only a small number of projects along the border. The need in my region is too great for the bank to have money sitting idle, but I think the Bank's problems can be fixed.

I believe that several of the proposals for reform could be useful in allowing the bank to fulfill its mandate and lend out its available capital. The most promising include funding more grants and low interest rate projects, as well as broadening the categories of projects which the bank is able to fund. I want to thank the committee for holding this hearing to find ways of making the bank more effective.

I am especially pleased that my good friend, Ernesto Silva, the City Manager of my hometown of Mercedes, TX, has been invited to testify today. Mr. Silva has worked for Mercedes since 1997 and is responsible for its day-to-day operations including budgeting, planning, and coordinating with federal agencies.

Under his leadership, Mercedes has successfully undertaken numerous projects such as the Mercedes Master Water Plan, the Mercedes Colonia Project, and the Mercedes Elevated Storage Tank project. He has also worked with the City of Pharr on its Wastewater Interceptor project and the Pharr Wastewater Treatment plant.

Water is the most precious resource for everyone, particularly in the Lower Rio Grande Valley. Managing, conserving and cleaning up our water is a constant challenge. In order to gain passage of NAFTA, the NAD Bank was originally developed to be a partner in helping border communities deal with water and environmental issues.

Although it has not worked well up until now, I know that it can live up to this promise.

I look forward to hearing Mr. Silva's insights into how this partnership has or has not worked as a practical matter, and I am confident that his testimony will be extremely helpful to this Subcommittee as it continues its debate on how best to reform the NAD Bank. Thank you again, Mr. Chairman, for yielding me this time for me to introduce Mr. Silva.

Solomon Ortiz
TX-27th

Statement of Congressman Solomon P. Ortiz
Committee on Financial Services
Subcommittee on International Monetary Policy and Trade
Thursday May 2, 2002

Thank you for your commitment to the quality of life for border residents who have experienced both the successes and the failures of the North American Free Trade Agreement (NAFTA.)

The economic climate in the wake of NAFTA has lifted many people out of poverty and offered jobs to border residents; yet there are pockets of communities who have not benefited. One of the greatest burdens on the border community is the crush of commerce and traffic, which serves every other state in the union. Simple geography has caused crushing environmental damage by virtue of the pollutants and engine discharge of long lines of cars and trucks waiting to cross the border. That leaves local taxpayers holding the check. That's wrong.

The North American Development Bank (NADBank) was established to combat the detrimental effects of NAFTA to the environment and the infrastructure along the southwestern border of the United States. In conjunction with the Border Environmental Cooperation Commission (BECC), a commission designed to ensure that projects improve the environment, NADBank strives to improve the southwestern border by granting loans to improve water, wastewater, and various other related infrastructure projects to struggling communities in the area.

Unfortunately, NADBank has not been able to fully live up to the goals that it set it out when it was created: providing assistance to border communities for the improvement of the environment and infrastructure. It should be made clear that the environment and the infrastructure along the southwestern border are not mutually exclusive. Any proposals that would limit NADBank's ability to ensure that both are equally addressed would be counterproductive.

This institution is immensely important to the border and to the millions of people that it serves. Anything that would limit the intentions of Congress regarding NADBank and its goals should be scrutinized very closely. When all is said and done, I hope that the NADBank mandate will be expanded to include more infrastructure projects rather than limited to just an environmental aspect.

Thank you again for your commitment to border residents and for holding this hearing. In doing so, you are sending the message that border citizens and this institution are important elements in our endeavor to secure free and fair trade with the rest of the world. I'm quite sure that together we can improve the quality of life for this important region of the country.

Testimony of Congressman Silvestre Reyes
United States House of Representatives, Financial Services Committee
Hearing of Proposed Changes to the World Bank, International Development Association, and the North American Development Bank
May 2, 2002

Mr. Chairman:

Thank you for giving me the opportunity to submit testimony to the Financial Services Committee about an issue that is extremely important to the residents who live along the United States - Mexico border. As you are well aware, the needs along the U.S. - Mexico border are ever increasing. Population growth is rapid, estimated at more than 100 percent in the next 20 years. Today about 11 to 12 million people live along the border. By 2020, 22 million people will reside in the region. On the U.S. side of the border, the per capita income is 79 percent of the national average. Four of the ten poorest counties in the United States are along the U.S. - Mexico border.

In October of 1993, the United States and Mexico agreed to a new institutional structure to promote border environmental cleanup. The North American Free Trade Agreement (NAFTA) authorized the establishment of the North American Development Bank (NADBank) and the Border Environment Cooperation Commission (BECC) which work jointly to address some of the many environmental problems caused by free trade between Mexico and the United States. The primary focus of these two organizations has been to address the water and waste water needs of communities in the border region. The BECC is directed to help border states and communities coordinate, and design environmental infrastructure projects, and to certify projects for financing, while the NADBank evaluates the financial feasibility of projects certified by the BECC and provides financing as appropriate.

Despite the creation of the NADBank to provide loans to finance border environmental infrastructure projects, grants from the Environmental Protection Agency (EPA) have accounted for the vast majority of funding provided through the NADBank thus far. A problem has been that the financing provided by NADBank is often at too high of an interest rate to be affordable by many impoverished communities. The structure of the BECC and NADBank needs to be adjusted in order to better meet the needs of communities along the border. It is estimated that $8 billion would be required to address needs for sewage treatment, drinking water, and municipal solid waste infrastructure projects along the border over the next decade. Investing resources to reduce or prevent pollution is often a much more cost effective means of improving the environment and avoiding environmental health problems than spending resources on regulation, treatment, storage, and disposal.

I am pleased that the Presidents of the United States and Mexico have agreed that fundamental changes to the BECC and the NADBank are needed. The two governments agreed to increase NADBank's ability to extend affordable financing. This will include doubling the size of NADBank's Low Interest Rate Lending Facility, from the $50 million level set in November of 2000 to $100 million. I believe that this figure is still too low and should be set at $200 million. In addition, $50 million of the NADBank's paid-in capital will be available for grant financing.

This is an important step, however, more funds should be set aside for this important program. No matter how low the interest rates are, there are many communities along the U.S. - Mexico border who will simply be unable to afford loans. Increased grant funding up to $100 million targeted at the poorest communities should be a priority for NADBank and BECC reform.

In addition, funds should be set aside to assist our colonia residents who are in dire need of very basic infrastructure. As you know, colonias are unincorporated communities, many of which do not have the basic necessities such as running water, sewage facilities, and paved roads. These communities suffer from dire environmental conditions and a host of unsanitary living conditions which should not be tolerated in our country. Grants, specifically targeted to colonias, are needed to assist these communities with their water and wastewater needs.

In order to expand the capacity of both institutions to address important binational environmental needs, the geographic scope for BECC/NADBank operations in Mexico will be expanded from 100 km to 300 km from the border. The geographic limit in the United States will remain unchanged at 100 km from the border. There is no doubt that the area encompassed within 100 km from the border is the area with the most dire needs. However, infusing additional funds within 300 km of the border on the Mexican side makes sense in helping build infrastructure and expanding the economy on Mexico's northern border. Assisting Mexico with infrastructure development needs in its northern border region will eventually relieve some of the pressure on the U.S. side of the border by providing opportunities for Mexican residents in Mexico. I support the geographic expansion on the Mexican side of the border but will oppose any expansion of the geographic charter on the U.S. side. In the U.S., the needs within the 100 km region are vastly different than those 300 km from the border.

I understand that the administrations of both countries have agreed that grant financing will be provided to the poorest communities located within the current border region of 100 km in both countries, and up to 25 percent of low interest rate lending may be made available for projects located between 100 km and 200 km in Mexico. Projects located between 200 km and 300 km in Mexico would be allowed to borrow at standard NADBank interest rates and receive normal technical assistance. I support these changes.

In order to improve functional coordination and operational efficiency between the BECC and the NADBank, the administration proposes that the two boards of directors will be replaced by a single board. The new board will have representation from the federal governments, the border states, and the public. In addition, a comprehensive "business process review" will be initiated to identify ways to improve the overall project design, certification, and implementation process. I agree with these structural changes, but am concerned about how the business process review will take place. It seems to me that it will be difficult to determine if the changes that are taking place within the NADBank and the BECC are effective until there is adequate time to evaluate the changes. The Administration is proposing to perform the business review simultaneously while structurally changing the BECC and NADBank. I am concerned that the Administration may be rushing an effort to validate the results of the reorganization, rather than objectively addressing whether or not the changes are effective. I think that a third party review of the NADBank and the BECC to study where structural inefficiencies should be improved should take place.

Finally, it is important that BECC and NADBank remain focused on addressing environmental needs in the border region. The institutions will expand their environmental mandate into areas including water conservation, air quality, and renewable energy, in addition to the original focus on clean water, the treatment of wastewater, and the handling of solid waste. The needs along the U.S. - Mexico border are so great that creative solutions need to be found to address many of the environmental problems in the region. The expansion of the charter to include other environmental issues is welcomed as long as the focus remains on addressing water and wastewater issues.

Mr. Chairman, thank you for giving me this opportunity to submit testimony to you and the Members of the House Financial Services Committee. I applaud the changes that are being made with the NADBank and the BECC and look forward to real progress being achieved along the U.S. - Mexico border to issues that are critically important to the environment and its residents.

Financial Services Subcommittee on International Policy and Trade
United States House of Represenatives
Testimony of Congressman Ciro D. Rodriguez
NADBank Restructuring
May 2, 2002

Chairman Berueter and Ranking Member Sanders, thank you for the opportunity to share my thoughts with the Subcommittee regarding the importance of the North American Development Bank (NADBank) to the future of the border region and the Nation. I appreciate the Subcommittee's interest in addressing the needs of the border region through improvements to NADBank. The future success of NADBank is critical to my constituents along the border and in San Antonio.

A history of failing to invest in our border region with Mexico, along with a host of other political, demographic and economic factors, has produced a border that faces incredible obstacles. Infrastructure needs for water quality, wastewater and solid waste are legion. Our southern border is under-served, poor and fast-growing. According to one report, the border population will grow by 100 percent in the next 20 years, by some 112 million people. One-third of that growth is expected on the U.S. side of the border. Poverty is widespread. NAFTA has spawned rapid industrialization in many areas, creating both business opportunities and environmental challenges.

The region is dreadfully poor. Six of the ten poorest counties in the U.S. are on the border, and Starr County, which I represent, ranks as the poorest in the country. The widespread infrastructure deficiencies produce multiple health risks and complications. The border region suffers disproportionately from numerous diseases patterns related directly or indirectly to environmental factors, including hepatitis A, diarrheal diseases, respiratory illnesses, shigellosis, typhoid fever and dengue fever. Unsanitary living conditions and high population mobility contribute to these and a host of infectious diseases that plague the border.

Testimony of Congressman Ciro D. Rodriguez
NADBank Restructuring
May 2, 2002

The NADBank, a binational financial institution created as part of the NAFTA negotiations, has a crucial mission, one that has only partially been fulfilled. A recent report states that NADBank has provided only a very small amount of loan commitments: only seven projects worth approximately $11 million. Limited in its ability to provide direct funding, NADBank has spearheaded numerous programs to meet the many border region needs. For example, grants funded by the Environmental Protection Agency (EPA) through the Border Environment Infrastructure Fund (BEIF) program and the Solid Waste Environmental Program, the NADBank has channeled millions of dollars of capital to improve infrastructure and environmental conditions. These improvements, in turn, enhance the quality of life and local economy for thousands of families on both sides of the of the US-Mexico Border. I would like to commend the staff and board of the institution for their commitment to those communities.

I urge the subcommittee to examine ways to expand NADBank's ability to provide low-cost loans and an increasing amount of grants. I urge the Administration and this subcommittee to fully explore all possible funding mechanisms that may be made available to the NADBank. Too many communities along the border do not have even basic resources, nor the ability to service commercial-rate loans. While development must be sustainable in the long-term, too many communities currently do not have the ability to take even the first steps toward infrastructure improvements.

Moreover, while the water-related needs of the border are tremendous, we need to examine ways to broaden the scope of projects for which NADBank can provide direct and indirect assistance. Economic development is crucial to the long-term survival of border communities. Improved transportation infrastructure, for example, provides new business opportunities, which in turn brings in revenues to allow border cities and towns to invest further.

Testimony of Congressman Ciro D. Rodriguez
NADBank Restructuring
May 2, 2002

Although I have been pleased with contributions the NADBank has made to the region, I also realize the ongoing need to improve and streamline the operations of the institution and its sister institution, the Border Environment Cooperation Commission (BECC). The two institutions have the potential to invigorate the border region and provide real and lasting economic opportunity for both sides of the border. In order to fulfill this potential, however Congress must give the NADBank and BECC more flexibility to inject capital into these low-income areas.

NADBank should remain headquartered in San Antonio, a unique city both part of and apart from the border itself. With its historical ties to Mexico and its growing international business sector, San Antonio offers NADBank many advantages. An extensive pool of bilingual employees, numerous area colleges and universities, and accessibility to various border points by road, air and rail are among local advantages. As one example, NADBank has enlisted the University of the Incarnate Word in San Antonio to facilitate the Utility Management Institute (UMI), a professional development program implemented to insure viability in all NADBank funded utility projects. Housed 200 miles away from the border in San Antonio, the institution has been able to provide unbiased leadership for the entire border region from Nogales, Arizona to Puerto Palomas, Chihuahua and from Roma, Texas to Tecate, Baja California.

We must give residents along the border the opportunity to fully reap the benefits of trade. Unfortunately, too many communities continue to languish. It is my hope that we will devote the full measure of our resources to improving the environmental, transportation, health, and educational infrastructure of the U.S.- Mexico border region. NADBank is an essential component in building the future of our border. A strong binational commitment to this shared community can make our goals a reality.

Chairman Brueter, Ranking Member Sanders, thank you again for this opportunity.

Statement by Congressman Max Sandlin
Subcommittee on International Monetary Policy and Trade
Hearing on Thursday, May 2, 2002

Mr. Chairman, I want to thank you for holding this hearing.

The North American Development Bank, the NADBank, is a pioneer in its field; the first and only development bank working to advance infrastructure development along the U.S./Mexico border. Created by NAFTA, the NADBank provides loan financing for environmental projects with a special focus on municipal water and wastewater treatment programs.

Under its current mission, the NADBank plays a critical role in restoring the long-neglected U.S./Mexican border. The bank helps the booming border population cope with the stresses placed on their environment and infrastructure after the passage of NAFTA. However, NADBank has the potential do even more to revitalize our border. Over the last few years, NADBank's mandate has been expanded to include, among other things, air quality improvement, public transportation and water management. New grant and low interest loan programs have also been created. These changes have been useful in further developing the bank's potential.

However, the current limitations placed on NADBank continue to restrict its ability to truly help boost economic development along the border. Small border communities often cannot rely on conventional loan financing, especially for water infrastructure, because, as a practical matter, many of these communities are extremely poor and cannot charge much for clean water.

I commend the President for making a commitment to border economic development. However, I am concerned that proposals being floated by the Administration would undermine the efforts to broaden the scope of the NADBank and make it more difficult to fulfill its mission of expanding the infrastructure of border communities.

While the district that I represent does not directly benefit from the NADBank, the State of Texas has a vested interest in making sure that our border communities are economically strong.

I hope that the Administration will continue to work with Members of Congress and the Mexican government to ensure the success of the mission of the NADBank.

Thank you, Mr. Chairman.

Hearing on the World Bank and the NAD Bank
Subcommittee on International Monetary Policy and Trade
Statement by Rep. Maxine Waters
May 2, 2002

I would like to thank Chairman Doug Bereuter for organizing this hearing on proposed changes to the World Bank and the North American Development Bank (NAD Bank). I am especially interested in the report of the Government Accounting Office (GAO) on the President's "loans-to-grants" proposal for the World Bank. I commend the GAO and its staff for their hard work in writing this report, and I appreciate the willingness of Mr. Joseph Christoff, the Director of International Affairs and Trade at the GAO, for his willingness to testify today.

Last year, President George W. Bush proposed that the World Bank convert 50% of its concessional lending to grants, which poor countries would not be required to repay. Providing assistance to poor countries in the form of grants would allow these countries to use World Bank funds for development purposes without adding to their existing debt burden.

I congratulate President Bush for offering this "loans-to-grants" proposal, and I am looking forward to working with the Administration and the World Bank to ensure that impoverished countries are able to receive development assistance in the future without continuously accumulating enormous external debts as they did in the past.

The GAO report on the loans-to-grants proposal concludes that while converting World Bank loans to grants would help some poor countries achieve debt sustainability, other poor countries would continue to bear the burden of unsustainable debts for many years to come. Only four of the ten countries studied by the GAO would achieve debt sustainability under the loans-to-grants proposal.

Poor countries will never be free from the crushing burden of debt until their existing debt stock is significantly reduced or completely canceled. Over the last three years, I have been working with members of the Financial Services Committee and supporters of the worldwide Jubilee 2000 Debt Relief Movement to end the crushing burden of poor country debts.

Last year, I introduced ***H.R. 1642, The Debt Cancellation for the New Millennium Act.*** This bill would require the International Monetary Fund and the World Bank to provide complete cancellation of 100% of the debts owed to them by impoverished countries. Over eighty Members of Congress representing both political parties have cosponsored this bill.

Two weeks ago, ***H.R. 4524, The Debt Relief Enhancement Act of 2002***, was introduced by a bipartisan group of Members of Congress, including Christopher Smith, John LaFalce, James Leach, Barney Frank, Spencer Bachus and myself. This bill would require the International Monetary Fund, the World Bank and other creditors to provide significantly deeper debt relief to impoverished countries.

Debt relief alone will not provide a lasting solution to the problem of poor country debts as long as poor countries are dependent on new World Bank loans for development assistance. Neither will converting the existing loans to grants provide a lasting solution to the problem of poor country debts as long as poor countries must continue to make payments on their existing debts. However, the cancellation of the existing debts combined with the loans-to-grants proposal could finally allow poor countries to invest in the development of their economies without forcing them to face another debt crisis like the one that led to the mobilization of the Jubilee 2000 Debt Relief Movement.

I look forward to hearing Mr. Christoff explain the GAO study on the President's loans-to-grants proposal in greater detail.

I thank the Chairman for the time.

WRITTEN TESTIMONY
for
SUBCOMMITTEE ON INTERNATIONAL MONETARY POLICY AND TRADE
of the
U. S. HOUSE COMMITTEE ON FINANCIAL SERVICES
addressing the
NORTH AMERICAN DEVELOPMENT BANK (NADBANK)
presented by
JOSE A. ARANDA, JR.
MAYOR
CITY OF EAGLE PASS

MAY 2, 2002

Good morning, Ladies and Gentlemen, and Members of the Subcommittee. My name is Jose A. Aranda, Jr. and I am currently the Mayor of the City of Eagle Pass, Texas. Thank you for the opportunity to comment on the Administration's proposed reforms for the North American Development Bank (NADBank)

In your role as Mayor of Eagle Pass, Texas, please describe your experience with the NADBank and the Border Environmental Cooperation Commission (BECC.)

The City of Eagle Pass, Texas (pop. 22,413) is located in Maverick County (pop. 47,297) in the Middle Rio Grande region approximately 140 miles south of San Antonio and bordering with Piedras Negras, Coahuila, Mexico. Like the rest of the southwest border communities, Maverick County has seen a 30% growth in the last decade. High growth rates often lead to an increase in the labor pool, but when a community lacks the economic resources to accommodate its citizens with jobs, poverty is inevitable. The percent living below the poverty level is 46.43 percent. Furthermore, the county's median household income is $17,150. Maverick County ranks 250 out of 255 counties.

The following testimony will explain both of the water treatment systems in Maverick County, the conception and growth of our current project, the challenges we have faced with NADBank, and possible solutions to current problems.

Eagle Pass has a water treatment plant servicing 10,500 metered users within the City and Maverick County which has been operating since 1949. The System's source of water derives from the Rio Grande River which is highly polluted. Major problems in the areas of capacity for future growth and compliance with new regulations dictated from the Environmental Protection Agency (EPA) and the Texas Natural Resources and Conservation Commission (TNRCC) have made this an undependable water treatment facility for our rapidly growing areas.

El Indio Water Supply Corporation is a rural water corporation sponsored by the United States Department of Agriculture. It obtains its water from an irrigation system derived from the Rio Grande and servicing those residents outside the City limits of Eagle Pass. Its water treatment plant was originally designed for 1400 connections; however, it currently has over 2000 connections, a waiting list of over 400, an obligation to provide new service to 4,000 newly developed lots, and absolutely no capacity for fire protection. El Indio Water Supply Corporation has experienced times where the water is not drinkable and, apart from the hundreds of residents that are affected, there are three elementary schools, a health clinic, a head start school, two Texas Migrant Council schools, and the Kickapoo Traditional Tribe of Texas Reservation. All of these groups including residential customers are importing water and/or are boiling water for use. El Indio Water Supply Corporation has been cited numerous times by the TNRCC for the improper treatment of its water thereby posing a high health hazard to its clients.

In 1995, the City of Eagle Pass constructed a 6-million gallon per day wastewater treatment plant sufficient to accommodate Eagle Pass growth but not the additional flows that would be generated by the El Indio area and Kickapoo Tribe requirements. Currently, the majority of Maverick County residents outside of the city limits of Eagle Pass have inadequate water systems, inadequate septic tanks, inadequate roads, inadequate housing, and inadequate fire protection.

In 2001, the City of Eagle Pass in conjunction with El Indio Water Supply Corporation agreed that their needs and problems would be resolved by the construction of a 20-million gallon per day regional water plant. The proposed plant will have a capacity to provide adequate and dependable water services to approximately 97% of the population of Maverick County including the Kickapoo Tribe, through the year 2024. It includes the construction of 3 elevated storage tanks, major transmission lines, and construction of the east central wastewater interceptor among many other improvements. The City of Eagle Pass will assume full financial and management responsibility of the project. This proposed regional plant is divided in 2 phases and is scheduled to be completed by 2007. Under this regional plan, it is also proposed that a collection system be installed throughout the Colonias in the El Indio Water Supply Corporation area and that a 2.5 million gallon Wastewater Treatment Plant be constructed. The total cost of the entire project is $101,440,404.00, of which Eagle Pass' portion will be $53,482,577 and El Indio Water Supply Corporation's portion will be $47,957,827. Local Community Development Block Grant funds will be added to this project in the amount of $1,708,600 for a total of $103,115,507. (Exhibit A)

After careful studies and because the funding of the project is beyond the City's capabilities, the City of Eagle Pass submitted applications to the Texas Water Development Board, NADBank and the Border Environment Cooperation Commission for possible funding. The Texas Water Development Board has provided $50 million in financial assistance, the Border Environment Cooperation Commission has provided $1,280,000 for technical assistance (planning and design), and NADBank has offered $14 million in transition assistance and $4 million in hook-up assistance for project development. In spite of this help, the NADBank has fallen short of providing the financial assistance which was originally anticipated. From seeing what some of the other Texas projects have received in funding from the NADBank, the City understood that it could potentially be eligible for approximately $25 million of grant financial assistance from the NADBank. In early February 2002, the City was informed that this was not the case and that the City would only receive $13.9 million in transition assistance and $4 million for hook-up assistance.

The City has, on several occasions, pled its case to the NADBank as to why their analysis of the impact on City residents is flawed. Attached to my written testimony are copies of letters (Exhibit B) sent to the NADBank, wherein we justify the need for construction grant assistance.

Of importance to note is the following:

⇒ The City is in effect proposing to prevent health threats associated with the inability of a water supply corporation to provide potable water to its estimated 10-14,000 residents.

⇒ The City has no responsibility to extend this service to residents that do not reside in the City, but has recognized that it has a moral obligation to assist if it can.

⇒ This project will also benefit the economic and residential projects proposed by the Kickapoo Tribe.

⇒ The NADBank has been unwilling to recognize that providing grant assistance for construction costs today, as opposed to the proposed transition assistance over a 7 year period, would reduce the City's debt burden by almost double the amount of assistance. (For example, if the NADBank provides $14 million in transition assistance over 7 years, this only pays for $14 million of debt service. However, if the same $14 million is provided for construction assistance today, that reduces the amount of debt and interest on that debt which amounts to ~$24.7 million using current proposed rates.)

⇒ It is our understanding that in preparing its analysis of "sustainable rates" the NADBank has developed a "state average" by customer size. Well, we all know that the border region is way below average in income, which is why the State of Texas has classified these areas as economically disadvantaged. So, to compare a state average utility rate with those that can be afforded by border residents is hard to comprehend.

In order to proceed with project certification from the BECC the City felt compelled to accept the offer of the NADBank, but still contends that the financing package offered by the NADBank is **not affordable or sustainable.**

According to NADBank affordability guidelines for the border environment infrastructure fund, if a project requires rate increases of 5% or more, the project is eligible for transition assistance.

Likewise, if a project requires costs that exceed 1.7% of income, the project is eligible for construction assistance, and "if the debt retirement increases exceed 10% per annum, construction assistance may be necessary".

We suspect it will appear affordable and sustainable but the costs will not appear affordable and sustainable. The costs of the project will increase both our debt and our debt service by **ten times,** which easily exceeds the 10% threshold for construction assistance. We believe we have a cost problem not a rate problem, so construction assistance **is** necessary.

We do not believe that rates are the only measure of whether a project is affordable and/or sustainable. After the transition assistance is exhausted, the draft NADBank rate study indicated that the City's Water System will have to devote nearly 50% of its annual budget to debt service, which is neither affordable nor sustainable. It must be stressed that NADBank's transition assistance of $14 million over 7 years is helpful in establishing rates but does not help in keeping the City of Eagle Pass indebtedness at reasonable levels. The $39 million debt loan will require approximately 50% of the total revenues for debt service and will hamper the water system in meeting future expansion requirements. Furthermore, $16 million of principal and the related $9 million of interest benefits County residents, we do not believe that City residents should pay this $25 million of the benefit for County residents. Furthermore, it is unfair that our ratepayers are being asked to pay 85% of the City costs in addition to the 33% of the County costs. **The financing places an unfair burden on City ratepayers**.

NADBank should receive additional funding in order to better address the pressing needs along the border. Financial assistance programs should offer grant assistance as well as loan assistance. Grant assistance should focus primarily on construction assistance and secondarily on transition assistance. Loan assistance should offer loans in meaningful amounts on reasonable terms, which may require a retooling of the existing Low Interest Rate Lending Facility (LIRLF). Financial assistance programs should recognize the special needs of regional projects, which can place unfair burdens on the ratepayers of impoverished communities.

In summary, this is a very aggressive project, one that combines two systems into a large regional project that can be effectively managed and operated to the high standards that are required for health and welfare. This is the type of project that is needed to resolve the significant problems that have existed in trying to operate small, independent water and wastewater programs.

NADBank should be providing guidance and financial assistance, instead we have found many constraints and funding formulas that impede the realization of this project. We feel NADBank is not accomplishing in reality what in concept it was intended to accomplish.

In closing, I would like to petition this Committee to assist our border local governments by providing the NADBank with the adequate funds and modifications of its appropriation formulas to assist in addressing our border needs and improve the quality of life for its citizens.

Are you aware of the current reform proposals offered by President Bush and President Vicente Fox.

Yes. I have read the following reform proposals:

❖ - **North American Development Bank and Border Environment Cooperation Commission**

On March 22, 2002, the White House issued a press release on proposed reforms for the two international organizations.

For Immediate Release
Office of the Press Secretary
March 22, 2002

Fact Sheet
Nadbank/Becc Reform

Due to the urgent environmental infrastructure needs in the U.S.-Mexico border region, Presidents Bush and Fox directed a binational working group to hold a series of discussions with states, communities, and other stakeholders in the border region to develop recommendations designed to strengthen the performance of the North American Development Bank (NADBank) and the Border Environment Cooperation Commission (BECC).

Reforms. The Presidents accepted the recommendations and will direct their respective Administrations to work with their legislatures to make the recommendations reality. NADBank and BECC will remain focused on environmental infrastructure priorities and will continue their urgent work on projects as the recommended reforms are implemented. The key recommendations for improvement are as follows:

- Geographic Scope: To expand the capacity of both institutions to address important binational environmental needs, the geographic scope for BECC/NADBank operations in Mexico should be expanded from 100 km to 300 km from the border. This expansion would be coupled with a system of financial differentiation that concentrates grants and low interest rate loans for projects in the poorest communities located within the current border region of 100-km, in both countries. The geographic limit in the United States would remain unchanged at 100-km from the border.

- Financial Instruments: To provide a greater level of financial flexibility so that its capital can be used more effectively and creatively, NADBank should expand its ability to extend concessional financing by doubling its Low Interest Rate Lending Facility and increasing its capacity to provide grants out of its own resources.

- Organizational Structure and Process: To improve functional coordination and operational efficiency between BECC and NADBank, the two boards of directors should be replaced by a single board to oversee both institutions. This new board would have representation from the federal governments, the border states, and the public. At the same time, a comprehensive business process review should be initiated to identify ways to improve overall project design, certification, and implementation.

- Private Sector: To expand the tools available for financing projects that, among other things, mitigate industrial pollution, improve air quality, and recycle and reuse wastes, a more concerted effort should be made to certify and finance private sector environmental projects.

The United States and Mexico established the BECC and the NADBank in 1993 to help develop and finance environmental infrastructure projects within 100 km of either side of the U.S.-Mexico border. The BECC works with the border states and local communities to develop and certify projects, and the NADBank arranges financing for these projects.

One reform proposal involves extending the jurisdiction of the Border Environmental Cooperation Commission (BECC) from the existing range of 100 km south of the U.S. - Mexico border to 300 km. What is your view of this proposal? In this new active range, how many potential new projects does NADBank stand to finance?

I feel that this proposal is premature and in my point of view the NADBank and our government needs to address our border before we start thinking of expanding boundaries either south or north of the border. Something that needs to be considered is how projects in the expanded area would be funded; if they are to receive grant funding from the BEIF, funded from EPA, then these projects would reduce the available funding to U.S. projects.

A second reform proposal recommends that the two respective governing boards of the NADBank and BECC be merged into one body to oversee both institutions. The merged board would have representation from the federal government, the border states and the public. What is your view on this proposal?

I, like many others, will await the outcome of the independent business process review that will hopefully improve project development and certification. As Mayor, I support the State of Texas' position that state governments be an integral part of this new board; that priorities of the states, as was the regional solution in Maverick County, is not understood or was not considered by the NADBank in its financial proposal to the City of Eagle Pass. The State has requested a more integral role so that the needs of the state be more relevant in the NADBank funding process. We also recommend that the public representative be a border resident who understands our problems because of the potential impact projects have over the lives of many residents in the border region.

Is the current allocation of the NADBank/BECC budgets satisfactory? Are there particular areas geographically or by geographic locations that deserve BECC/NADBank .....

I am unsure of the level of funding currently being provided to the two institutions; however, we all know that the need in the entire U.S. - Mexico border region is substantial. I support funding that is used to make projects affordable to border residents, on both sides of the border, as the work on either side ultimately impacts both countries.

Is there any instance wherein the NADBank should be able to fund a project, particularly those of infrastructure, without BECC certification?

Yes. My experience with the Eagle Pass Regional Project is that there appears to be a duplication of work already being done by the States, especially as it relates to environmental, engineering and financial reviews.

For example, the Eagle Pass project received funding from the Clean Water and Drinking Water State Revolving Funds and the Colonia Wastewater Treatment Assistance Program, all funded through the EPA and which required a full NEPA review. (The National Environmental Protection Act, is a federal requirement that requires the preparation of an Environmental Information Document and the issuance of a Finding of No Significant Impact). Therefore, if the States are able to approve/certify projects that meet federal requirements, there might be opportunities there where the NADBank could coordinate its funding with the states without a BECC review, which can add several months time to the process.

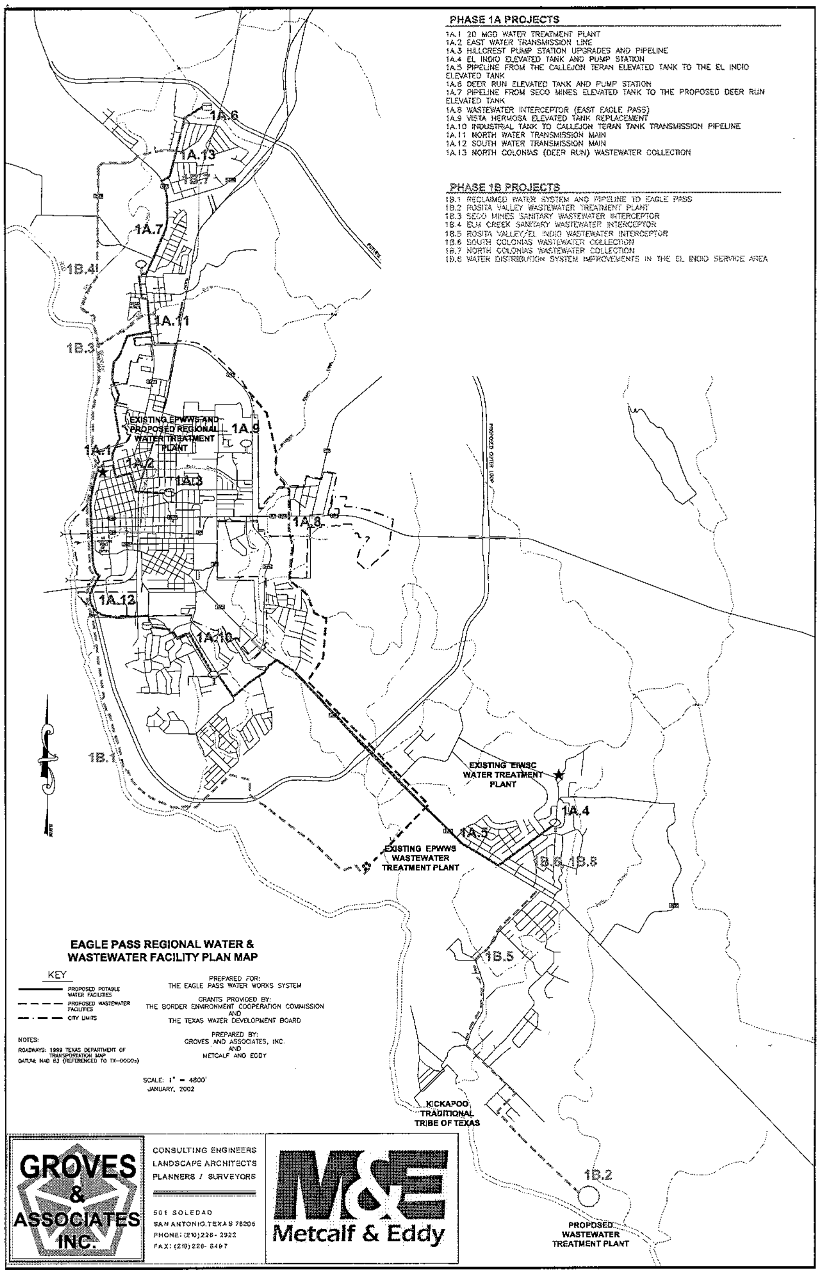
Do you have any suggestions for reform of the BECC and the NADBank. If so, what are your suggestions.

I suggest the BECC and NADBank ensure that their work in the region coincides with the funding priorities of the State and works in sync with State's funding timelines. This is why it is so critical that the State be an integral part on the future operation of these two institutions, they have the experience of implementing state and federal infrastructure programs, some of which have been funded by this and past congresses.

	A	B	C	D	F	G	I	K	M
1	**CITY OF EAGLE PASS, TEXAS**		S02A	S02B	S02C		S02D	S02E	DATED DATE: 07/01/2002
2	**PHASE 1A**								
3		(a1)			(a2)		(b1)		
4		(Non-Disadvantage)	(Disadvantage)						
5		**DWSRF**	**DWSRF**	**DWSRF**	**(formerly DFundII) DWSRF 2002**	**EDAP**	**(formerly DFundII) CWSRF 2002**	**DFundII**	**TOTAL**
6	**CONSTRUCTION**								
7	Water Treatment Plant - 16 MGD	8,748,381	9,983,619	18,732,000					18,732,000
8	Water Treatment Plant - 3 MGD	-	-			3,568,000.0			3,568,000
9	North Water Transmission Main & Pump Station	709,884	810,116	1,520,000		480,000.0			2,000,000
10	East Water Transmission Main & Pump Station	169,998	194,002	364,000					364,000
11	South Water Transmission Main & Pump Station	385,299	439,701	825,000		675,000.0			1,500,000
12	Deer Run Elevated Storage Tank	609,472	695,528	1,305,000		195,000.0			1,500,000
13	Seco Mines to Deer Run Transmission Main	411,284	469,356	880,640		495,360.0			1,376,000
14	Chula Vista (El Indio Area) Elevated Storage Tank	469,364	535,636	1,005,000		495,000.0			1,500,000
15	Industrial to Callejon Teran Transmission Main	88,268	100,732	189,000		231,000.0			420,000
16	Callejon Teran to Chula Vista Transmission Main	386,700	441,300	828,000		1,012,000.0			1,840,000
17	Vista Hermosa Elevated Storage Tank	350,272	399,728	750,000	750,000				1,500,000
18	East Central Wastewater Interceptor	-	-				6,000,000		6,000,000
19	**Total Construction**	12,328,922	14,069,718	26,398,640	750,000	7,151,360.0	6,000,000	-	40,300,000
20									
21	**BASIC ENGINEERING FEES**								
22	Planning	61,645	70,349	131,993	3,750	35,756.8	30,000		201,500
23	Design Engineering	693,502	791,422	1,484,924	42,188	402,264.0	337,500		2,266,875
24	Construction Phase Engineering	231,167	263,807	494,975	14,063	134,088.0	112,500		755,625
25	**Sub-Total Basic Engineering Fees**	986,314	1,125,577	2,111,891	60,000	572,108.8	480,000	-	3,224,000
26									
27	**SPECIAL ENGINEERING FEES**								
28	Inspection	122,377	139,656	262,033	7,445	70,984.4	59,556	-	400,018
29	Surveying	15,411	17,587	32,998	938	8,939.2	7,500	-	50,375
30	Testing	18,358	20,950	39,308	1,117	10,648.4	8,934	-	60,007
31	Geotechnical	6,119	6,983	13,102	372	3,549.2	2,978	-	20,001
32	O&M Manual	24,473	27,928	52,401	1,489	14,195.4	11,910	-	79,996
33	**Sub-Total Special Engineering Fees**	186,738	213,104	399,842	11,360	108,316.6	90,878	-	610,396
34									
35	**OTHERS**								
36	Land & ROW Acquisition	45,888	52,367	98,256	2,792	26,617.4	22,332	-	149,997
37	Water Rights Acquisition	-	-			2,857,000.0		2,105,000	4,962,000
38	Archeology	31,764	35,817	67,581	1,976	23,941.6	15,131	-	108,629
39	Administration/Miscellaneous	27,190	30,659	57,849	1,691	20,494.0	12,952	-	92,987
40	**Sub-Total Others**	104,843	118,843	223,686	6,459	2,928,052.9	50,415	2,105,000	5,313,613
41									
42	**BOND ISSUANCE COSTS**								
43	Financial Advisor (fee schedule + expenses)	47,014	57,206	104,220	67,333		44,384	20,000	235,938
44	Bond Counsel ($1/1000 bonds + expenses)	21,563	25,262	46,825	20,716		15,005	9,645	92,191
45	Rounding								-
46	Rating Fee	15,000	-	15,000	3,000	-	13,000	10,355	41,355
47	Bond Insurance	173,000	-	173,000	10,761	-	82,410	-	266,171
48	**Sub-Total Bond Issuance Costs**	256,577	82,468	339,045	101,811	-	154,799	40,000	635,655
49									
50									
51	SUBTOTAL	13,863,392	15,609,711	29,473,103	929,629	10,759,838.4	6,776,092	2,145,000	50,083,663
52									
53	**Loan Origination Fee @ 2.25%(does not inc forgiveness)**	280,611	320,233	600,844	21,565	-		-	622,409
54	**Loan Origination Fee @ 1.85%**				-	-	136,321	-	136,321
55									
56	**Contingencies (based on % of Construction costs)**	1,610,996	1,835,056	3,446,053	28,806	1,115,161.6	592,587	-	5,182,607
57									
58									
59	**TOTAL PROJECT COST**	15,755,000	17,765,000	33,520,000	980,000	11,875,000.0	7,505,000	2,145,000	56,025,000

	A	B	F	J	N	R	V
1	**CITY OF EAGLE PASS, TEXAS**		S03A	S03B	S03C	DATED DATE: 05/01/2003	
2	**PHASE 1B**		(a3)	(b2)			
3		EDAP	(Formerly DFundII) DWSRF 2002	(Formerly DFundII) CWSRF 2002	(Formerly DFundII) CWSRF 2003	**CDBG Funds**	TOTAL
4	**WATER**						
5	El Indio Distribution System	$ 6,802,127	$ 2,516,464				$ 9,318,591
6	Service Taps (to prop. line only)	1,364,775	373,550				1,738,325
7	Service Connections (to house)					1,099,070	1,099,070
8	**Sub-Total Water**	**8,166,902**	**2,890,014**	**-**	**-**	**1,099,070**	**12,155,986**
9							
10	**WASTEWATER**						
11	Rosita Valley Wastewater Plant	1,300,000		1,200,000	-		2,500,000
12	El Indio/Rosita Interceptor	1,010,000			195,000		1,205,000
13	El Indio/Rosita Collectors (South)	7,185,000			840,000		8,025,000
14	Deer Run Area Collectors (North)	2,805,250			271,500		3,076,750
15	Elm Creek Interceptor	1,025,000			425,000		1,450,000
16	Seco Mines Interceptor	970,000		1,420,000	-		2,390,000
17	Service Hookups (to prop. line only)	814,800			137,400		952,200
18	Service Connections (to house)	1,493,800				251,900	1,745,700
19	**Sub-Total Wastewater**	**16,603,850**	**-**	**2,620,000**	**1,868,900**	**251,900**	**21,344,650**
20							
21	**RECLAIMED WATER**						
22	Eagle Pass	-		1,000,000	2,300,000		3,300,000
23	**Sub-Total Reclaimed Water**	**-**	**-**	**1,000,000**	**2,300,000**	**-**	**3,300,000**
24							
25	**Total Construction**	**24,770,752**	**2,890,014**	**3,620,000**	**4,168,900**	**1,350,970**	**36,800,636**
26							
27	**BASIC ENGINEERING FEES**						
28	Planning	123,854	14,450	18,100	20,845	6,755	184,003
29	Design	1,393,355	162,563	203,625	234,501	75,992	2,070,036
30	Construction	464,452	54,188	67,875	78,167	25,331	690,012
31	**Sub-Total Basic Engineering Fees**	**1,981,660**	**231,201**	**289,600**	**333,512**	**108,078**	**2,944,051**
32							
33	**SPECIAL ENGINEERING FEES**						
34	Inspection	245,874	28,686	35,932	41,381	13,410	365,283
35	Surveying	30,963	3,613	4,525	5,211		44,312
36	Testing	36,884	4,303	5,390	6,207		52,785
37	Geotechnical	12,294	1,434	1,797	2,069		17,594
38	O&M Manual	49,170	5,737	7,186	8,275		70,368
39	**Sub-Total Special Engineering Fees**	**375,185**	**43,773**	**54,830**	**63,143**	**13,410**	**550,341**
40							
41	**OTHERS**						
42	Land & ROW Acquisition	92,197	10,757	13,474	15,517		131,944
43	El Indio RD Debt Buy-Out	896,550					896,550
44	Archeology	64,321	7,263	9,345	10,442	-	91,371
45	Administration/Miscellaneous	55,059	6,217	8,000	8,938	-	78,213
46	**Sub-Total Others**	**1,108,126**	**24,237**	**30,818**	**34,896**	**0**	**1,198,078**
47							
48	**Sub-Total**	**28,235,724**	**3,189,225**	**3,995,248**	**4,600,452**	**1,472,457**	**41,493,106**
49							
50	**BOND ISSUANCE COSTS**						
51	Financial Advisor		10,725	23,987	106,811		141,524
52	Bond Counsel		4,941	12,145	52,160		69,246
53	Rounding						-
54	Rating		5,000				5,000
55	Bond Insurance		39,640.11	51,005.08	56,989.53		147,634.72
56	**Sub-Total Issuance Costs**	-	60,306.00	87,137.57	215,961.36	-	363,404.92
57							
58	**Loan Origination Fee**		79,438.00	84,372.00	94,271.00		258,081.00
59							
60	**CONTINGENCIES**	3,734,680	281,031	478,242	279,316	236,143	5,009,412
61							
62	**Total**	**31,970,404**	**3,610,000**	**4,645,000**	**5,190,000**	**1,708,600**	**47,124,004**
63							

Prepared by Estrada Hinojosa & Co., Inc.


PHASE 1A PROJECTS
1A.1 20 MGD WATER TREATMENT PLANT
1A.2 EAST WATER TRANSMISSION LINE
1A.3 HILLCREST PUMP STATION UPGRADES AND PIPELINE
1A.4 EL INDIO ELEVATED TANK AND PUMP STATION
1A.5 PIPELINE FROM THE CALLEJON TERAN ELEVATED TANK TO THE EL INDIO ELEVATED TANK
1A.6 DEER RUN ELEVATED TANK AND PUMP STATION
1A.7 PIPELINE FROM SECO MINES ELEVATED TANK TO THE PROPOSED DEER RUN ELEVATED TANK
1A.8 WASTEWATER INTERCEPTOR (EAST EAGLE PASS)
1A.9 VISTA HERMOSA ELEVATED TANK REPLACEMENT
1A.10 INDUSTRIAL TANK TO CALLEJON TERAN TANK TRANSMISSION PIPELINE
1A.11 NORTH WATER TRANSMISSION MAIN
1A.12 SOUTH WATER TRANSMISSION MAIN
1A.13 NORTH COLONIAS (DEER RUN) WASTEWATER COLLECTION
PHASE 1B PROJECTS
1B.1 RECLAIMED WATER SYSTEM AND PIPELINE TO EAGLE PASS
1B.2 ROSITA VALLEY WASTEWATER TREATMENT PLANT
1B.3 SECO MINES SANITARY WASTEWATER INTERCEPTOR
1B.4 ELM CREEK SANITARY WASTEWATER INTERCEPTOR
1B.5 ROSITA VALLEY/EL INDIO WASTEWATER INTERCEPTOR
1B.6 SOUTH COLONIAS WASTEWATER COLLECTION
1B.7 NORTH COLONIAS WASTEWATER COLLECTION
1B.8 WATER DISTRIBUTION SYSTEM IMPROVEMENTS IN THE EL INDIO SERVICE AREA
1A.6
1A.13
1B.7
1A.7
1B.4
1A.11
1B.3
EXISTING EPWWS AND PROPOSED REGIONAL WATER TREATMENT PLANT
1A.9
1A.1
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1A.8
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EXISTING EIWSC WATER TREATMENT PLANT
1A.4
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EXISTING EPWWS WASTEWATER TREATMENT PLANT
1B.6 1B.8
1B.5
KICKAPOO TRADITIONAL TRIBE OF TEXAS
1B.2
PROPOSED WASTEWATER TREATMENT PLANT
EAGLE PASS REGIONAL WATER & WASTEWATER FACILITY PLAN MAP
KEY
PREPARED FOR:
THE EAGLE PASS WATER WORKS SYSTEM
GRANTS PROVIDED BY:
THE BORDER ENVIRONMENT COOPERATION COMMISSION
AND
THE TEXAS WATER DEVELOPMENT BOARD
PREPARED BY:
GROVES AND ASSOCIATES, INC.
AND
METCALF AND EDDY
SCALE: 1" = 4800'
JANUARY, 2002
GROVES & ASSOCIATES INC.
CONSULTING ENGINEERS
LANDSCAPE ARCHITECTS
PLANNERS / SURVEYORS
501 SOLEDAD
SAN ANTONIO, TEXAS 78205
PHONE: (210)226-2922
FAX: (210)226-6497
M&E
Metcalf & Eddy

Eagle Pass Regional Water & Wastewater Facility Plan
Funding Sources as of 1/15/2002

		Eagle Pass		El Indio	
		Loan	Grant	Loan	Grant
Phase 1A	DWSRF	27,625,486		5,894,514	
	DFUND	8,322,892		2,307,108	
	EDAP		3,272,852		8,602,148
Phase 1B	CDBG	50,465		1,624,638	
	DFUND	6,825,093		6,619,907	
	EDAP		7,435,956		24,534,449
	Sub Total	**42,823,936**	**10,708,808**	**16,446,167**	**33,136,597**
	Sub Total	**53,532,744**		**49,582,763**	
	Grand Total	**103,115,507**			

January 25, 2001

Mr. Jorge C. Garcés
Deputy Managing Director
North American Development Bank
203 South St. Mary's, Suite 300
San Antonio, TX 78205

Dear Mr. Garcés:

Thank you for your offer of financial assistance for Phase IA and Phase IB of the $101,440,404 regional water and wastewater facilities plan for the City of Eagle Pass waterworks system. As a regional provider, the City's service area will increase to a total population of 53,172 in 2005, serving residents of the County, including the El Indio Water Supply Corporation, which encompasses the Kickapoo Indian Nation.

Due to the regional nature of the project and the serious health and safety problems the project will solve, it was necessary to seek funding from a number of sources, notably the Texas Water Development Board (TWDB) and the North American Development Bank (NADBank).

To date, we have secured the following financial commitments from the TWDB:

Amount	Nature of Funding	Share of Project
$43,845,404	grant	43.22%
$ 6,215,000	loan forgiveness	6.13%
$11,545,000	no-interest loan	11.38%
$15,760,000	low-interest loan	15.54%
$24,075,000	high-interest loan	23.73%

Although much of this assistance is either grant, loan forgiveness, no-interest loan, or low-interest loan, the $24 million loan from the Texas Water Development Fund II (DFund II) has an above-market interest rate; this is the portion of the financing package where we most require the assistance of the NADBank.

As you know, we have been discussing the project with your staff and their predecessors for several years. Initially, NADBank staff had advised us on a preliminary basis that NADBank would likely offer construction assistance of at least $25 million and transition assistance in an undetermined amount. Obviously, the $25 million of assistance would have eliminated the $24 million high-interest loan.

Now, NADBank staff advises us that NADBank will offer NO construction assistance and $14 million of transition assistance. Also, NADBank staff advises us that $4 million of hookup assistance is available. (The hookup assistance covers costs that are above and beyond the $101 million cost of the project.)

The NADBank assistance is sized to ensure that customers pay rates that are affordable and sustainable. We await the results of the rate study, and we suspect that the *rates* will appear affordable and sustainable, according to the guidelines developed by NADBank and implemented by the rate consultant.

Even if the *rates* appear affordable and sustainable, the *package* is NOT affordable and sustainable. We believe that the financing places an undue burden on City ratepayers, as opposed to County ratepayers. In addition, we remain concerned that the rate study does not reflect all known costs of the system; namely project costs for Phase 3 of $27.2 million are not included in the rate study.

Mr. Jorge C. Garcés
Page 2

WE RESPECTFULLY REQUEST AN ADDITIONAL $11 MILLION OF ASSISTANCE.

The financing package is NOT affordable and sustainable.

For the fiscal year ended September 30, 2000, the City of Eagle Pass had cash expenses of $3,032,687. The City had $4,340,000 of bonds and paid $578,016 of annual debt service (or 19% of expenses.)

As planned, for the fiscal year ended September 30, 2007, the City will have cash expenses of $5,520,522. The City will have $45,485,000 of bonds and pay $5,387,451 of annual debt service (or 98% of expenses.)

In other words, this package will DOUBLE our expenses. At the same time, the package will increase both our debt and our debt service by TEN TIMES, so that debt service will EQUAL operating expenses. Obviously, we do not believe that this ratio of debt service to cash expenses is affordable or sustainable.

The financing places an undue burden on City ratepayers.

Approximately $16.5 million of loan proceeds benefits County residents, rather than City residents. Also, in addition to the principal, the $16.5 million loan will cost the City another $9.0 million of interest.

The City would likely not have undertaken a project of this magnitude without the support of NADBank. We do not believe that City residents should pay this $25.5 million for the benefit of County residents.

There is a $25.0 million shortfall in the package that is only partially addressed by the $14 million offer. As described above, the cost to the City ratepayers for the benefit of the County ratepayers is $25.5 million. In preliminary conversations with your staff and their predecessors, we expected an offer of $25.0 million. Looking at the TWDB assistance, the difficult portion of the package is the high-rate loan of $24.0 million.

If the package is not deemed affordable and sustainable, the City may need to finance the City portion only. This would delay the projects, because it would require another approval from TWDB and other agencies. More important, the El Indio portion would not be funded, and El Indio lacks the capacity to fund it alone.

The rate study does not reflect all known costs of the system.

The NADBank rate study does not consider funding for Phase 3 of the project, which will cost another $27.2 million in 2010. NADBank's offer of assistance does not leave us any flexibility to fund this phase.

Also, the NADBank rate study does not consider non-cash items, such as amortization and depreciation. We understand that the "cash-needs approach" recovers the capital cost by including principal payments, which is appropriate for the assets to be funded. However, for the existing assets currently in operation, the non-cash items of almost $1 million are almost TWO TIMES the principal payments for existing debt.

In addition, we are concerned that the TWDB, as our lender, may require more rate increases in the future to avoid depleting our fund balance and to ensure that our assets are adequately funded.

Mr. Jorge C. Garcés
Page 3

The financing package should include construction assistance, as well as transition assistance.

If at all possible, we would like to receive construction assistance, as well as transition assistance. As you know, construction assistance reduces debt, whereas transition assistance reduces debt service.

If we assume a $50 million bond, amortized at a 5.5% interest rate on a level amortization over 25 years, $20 million of construction assistance will eliminate $20 million of principal and $17 million of interest, whereas $20 million of transition assistance will eliminate only $20 million of principal and interest.

Since the construction costs and some of the debt service costs will be incurred in the first seven years, if we receive construction assistance, rather than transition assistance, the package will be more efficient. Also, construction assistance, rather than transition assistance, would resolve a potential problem arising from the federal tax law, which we are discussing with your staff and exploring with our bond counsel.

Thank you for your consideration. We are mindful that the City and the NADBank must resolve this issue. We hope to resolve this issue prior to February 1, when we will be holding the public hearing necessary to prepare for certification at the March meeting of the Border Environment Cooperation Commission.

Jorge, we appreciate your continuing interest in the City of Eagle Pass. If we can assist you in any way, please feel free to call us at (830) 773-9170.

Sincerely,

José A. Aranda, Jr.
Mayor

cc: The Honorable Senator Phil Gramm
The Honorable Senator Kay Bailey Hutchison
The Honorable Representative Henry Bonilla
Mr. Gregg Cooke, Regional Administrator, USEPA
The Honorable Governor Rick Perry
The Honorable Senator Frank Madla
The Honorable Representative Pete G. Gallego
Mr. Craig D. Pedersen, Executive Administrator, TWDB

February 11, 2002

Mr. Jorge C. Garcés
Deputy Managing Director
North American Development Bank
203 South St. Mary's, Suite 300
San Antonio, Texas 78205

Dear Mr. Garcés:

Tuesday, we met with your staff to discuss my letter of January 25, concerning the offer of financial assistance from the North American Development Bank (NADBank) to the City of Eagle Pass.

As you recall, the project consists of Phase IA and Phase IB of the $101,440,404 regional water and wastewater facilities plan for the City of Eagle Pass Water Works System. NADBank has offered to provide $14 million of "transition" assistance, to assist the City with its debt service payments, as well as another $4 million of "hookup" assistance, to assist our customers with the cost of hooking up to our system.

<u>The financing package is NOT affordable and sustainable.</u>

According to NADBank affordability guidelines for the Border Environment Infrastructure Fund (BEIF), if a project requires rate increases of 5% or more, the project is eligible for transition assistance. Likewise, if a project requires costs that exceed 1.7% of income, the project is eligible for construction assistance, and "if the debt retirement increases exceed 10% per annum, <u>construction assistance may be necessary</u>."

We await the results of the rate study, and we suspect that the rates will appear affordable and sustainable, but the costs will not appear affordable and sustainable. The costs of the project will increase both our debt and our debt service by <u>TEN TIMES</u>, which easily exceeds the 10% threshold for construction assistance. We believe that we have a cost problem, not a rate problem, so construction assistance is necessary.

We do not believe that rates are the only measure of whether a project is affordable and/or sustainable. After the transition assistance is exhausted, the draft NADBank rate study indicated that the city will have to devote nearly 50% of its annual budget to debt service, which is neither affordable nor sustainable.

The financing places an unfair burden on City ratepayers.

As you know, $16 million of principal and the related $9 million of interest benefits County residents. We do not believe that City residents should pay this $25 million of the benefit of County residents. There is a funding gap of $11 million, which is this $25 million cost less the $14 million assistance.

If your letter of February 1, you indicated that the project produces a ratio of 57% grant and 43% loan. Actually, the City portion of the project produces a ratio of only 20% grant and 80% loan, whereas the County portion of the project produces a ratio of 67% grant and 33% loan. We do not believe that it is fair that our ratepayers are being asked to pay 80% of the City costs in addition to 33% of the County costs.

In my letter of January 25, we respectfully requested an additional $11 million of assistance, preferably construction assistance, rather than transition assistance. Because construction assistance reduces debt, every $1.00 of construction assistance produces $1.77 of reduction in our principal and interest payments. (By contrast, every $1.00 of transition assistance produces only $1.00 of reduction in our payments.)

We understand that NADBank prefers to offer transition assistance, rather than construction assistance, because other communities, both in Mexico and the United States, have been reluctant to raise their rates. We hope that you will recognize that the City has demonstrated its ability and willingness to raise rates. The system, run by a separate board, has a good relationship with the Texas Water Development Board; and the TWDB has an audit staff, which monitors its borrowers on a regular basis, to ensure compliance.

When we met with your staff, we were told that we could apply the $4 million of hookup assistance as construction assistance. This $4 million of assistance helps us to close the funding gap of $11 million, since we believe that we can obtain hookup assistance elsewhere. A funding gap of $7million remains.

We respectfully request an additional $7 million of construction assistance.

Jorge C. Garcés
Page 3

Thank you for your consideration. We are mindful that the City and the NADBank must resolve this issue. We hope to resolve this issue prior to the meeting of the Border Environment Cooperation Commission.

Jorge, we appreciate your continuing interest in the City of Eagle Pass. If we can assist you in any way, please feel free to call us at (830)773-1111.

Sincerely,

CITY OF EAGLE PASS

Jose A. Aranda, Jr.
Mayor

xc: The Honorable Senator Phil Gramm
The Honorable Senator Kay Bailey Hutchison
The Honorable Congressman Henry Bonilla
Mr. Gregg Cooke, Regional Administrator, USEPA
Mr. Fernando R. Macias, Border Environment Cooperation Commission
The Honorable Governor Rick Perry
The Honorable Frank Madla
The Honorable Representative Pete G. Gallego
Mr. Craig D. Pedersen, Executive Administrator, TWDB

- File
NAD BANK

THE CITY OF EAGLE PASS 1849

March 26, 2002

Mr. Fernando R. Macias, General Manager
Border Environment Cooperation Commission
Blvd. Tomas Fernandez, No. 8069
Fracc. Los Parques
Cd. Juarez, Chihuahua, C.P. 32470

Dear Mr. Macias:

Thank you for your offer of financial assistance for Phase IA and Phase 1B of the $101,440,404 Regional Water and Wastewater Facilities Plan for the City of Eagle Pass Waterworks System.

The North American Development Bank (NADBank) and the Texas Water Development Board (TWDB) encouraged us to pursue a regional project, which would benefit County residents, not just City residents. We will require substantial assistance from these agencies in order to complete such an ambitious project.

The TWDB has offered $101,440,404 in grants, loan forgiveness, no-interest loans, and low-interest loans. NADBank has offered only $4 million of construction assistance and $14 million of transition assistance.

Sadly, despite too many discussions about constraints and models and precedents and regulations, there have been no discussions of the "big picture" issues concerning who should pay for projects of this type.

We remain concerned that the financing package is not affordable and sustainable. Within seven years, this package will DOUBLE our expenses. At the same time, the package will increase both our debt and our debt service by TEN TIMES, so that debt service will EQUAL operating expenses.

We believe that the package places an unfair burden on City ratepayers, as opposed to County ratepayers. Approximately $16.5 million of loan proceeds benefits County residents, rather than City residents. Also, in addition to the principal, the $16.5 million loan will cost the City another $9.0 million of interest.

Note:
Mailed only

We believe that the package limits the financial flexibility of the system and precludes the system from accessing the markets through any source but the NADBank, the TWDB and other lenders of last resort. Also, we face costs of $27.3 million to complete Phase 3 of the project, which are still not funded.

We are gravely concerned about the cost of the project to the City, in light of the current financing package, and we will continue to seek additional assistance, so that we can complete this essential project.

Thank you for your attention. If you should have any questions in regard to this matter, please do not hesitate to contact us at (830)773-1111.

Sincerely,

CITY OF EAGLE PASS

Jose A. Aranda, Jr.
Mayor

xc: Mr. Jorge C. Garcés, Deputy Managing Director
North American Development Bank

United States General Accounting Office

GAO

Testimony

Before the Subcommittee on International Monetary Policy and Trade, Committee on Financial Services, House of Representatives

For Release on Delivery
Expected at
10 a.m., EDT
Thursday
May 2, 2002

DEVELOPING COUNTRIES

Switching Some Multilateral Loans to Grants Would Lessen Poor Country Debt Burdens

Statement of Joseph A. Christoff, Director
International Affairs and Trade

GAO Accountability * Integrity * Reliability

GAO-02-698T

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the impact that switching some loans to grants would have on poor countries' debt burdens.

In July 2001, President Bush proposed that the World Bank and other development banks replace 50 percent of future loans to the world's poorest countries with grants. A goal of this proposal was to relieve poor countries' long-term debt burdens. The president's grants proposal would mean a significant change for multilateral institutions such as the World Bank, which traditionally use low-cost loans to deliver development assistance. The World Bank estimates that this controversial proposal would result in a financial loss of $100 billion over the next 40 years.

As discussed in our recent report,[1] we found that the proposal to shift 50-percent of multilateral institutions' loans to grants (1) would help poor countries reduce their debt burdens, and (2) would cost the World Bank $15.6 billion, which could be financed through relatively small increases in donor contributions.

In conducting our work, we used World Bank and International Monetary Fund (IMF) analyses that included detailed country-specific economic forecasts and projections of the financial implications of switching from loans to grants. However, we based our analysis on historical export growth rates for 10 poor countries,[2] in contrast to the highly optimistic rates assumed by the World Bank and IMF. We also built on prior work that examined World Bank and IMF 20-year projections on poor countries' debt burdens. The World Bank and the IMF reviewed and provided detailed comments on this earlier analysis. However, we were unable to discuss our new findings with World Bank and IMF officials because the Department of the Treasury did not approve our access to officials of those institutions. Treasury officials were concerned that our work would interfere with ongoing negotiations to refinance the World Bank's International Development Agency (IDA).

[1]See United States General Accounting Office, *Developing Countries: Switching Some Multilateral Loans to Grants Lessens Poor Country Debt Burdens*, GAO-02-593 (Washington, D.C.: April 19, 2002).

[2]The 10 countries chosen—Benin, Bolivia, Burkina Faso, Ethiopia, Mali, Mozambique, Nicaragua, Tanzania, Uganda, and Zambia—are geographically dispersed, represent a wide range of economic conditions, and receive about two thirds of internationally provided debt relief.

Summary

The Administration's proposal to replace 50 percent of multilateral loans with grants would lessen poor countries' debt burdens and increase their ability to repay future debt. Our analysis found that under the grants proposal 4 of the 10 countries we analyzed would be debt sustainable[3] for 20 years and 2 other countries would be debt sustainable for most of that period. Furthermore, the grants proposal is more effective in promoting debt sustainability than proposals to forgive 100-percent of old multilateral debt. Any advantage of the 100-percent debt forgiveness proposal is eliminated after 7 years because poor countries would accumulate new debt that will become unsustainable.

We estimate that the financial loss of the 50-percent grants proposal is $15.6 billion. Our estimate differs from the World Bank's projected loss of $100 billion over 40 years because we adjusted for the impact of inflation and the investment income that could accrue over time. We found that the World Bank could fully finance the grants proposal if donors increase their contributions by 1.6 percent a year, which is less than the expected rate of inflation over the next 40 years.

Background

During the 1970s and 1980s, many low-income countries sharply increased their external borrowing, mostly from other governments or multilateral institutions. During this period, the price of primary commodities tended to be high, contributing to optimistic export growth projections on the part of developing countries, which encouraged them to overborrow. By the end of 1997, the total external debt of the 42 countries classified as heavily indebted poor countries had a face value of more than $200 billion. Much of this debt was not being repaid or was repaid only with the support of donors. In 1996, the Heavily Indebted Poor Countries (HIPC) initiative was created to provide debt relief to these poor countries.[4] In 1999, the World Bank and IMF agreed to enhance the HIPC initiative by doubling the estimated amount of debt relief to over $28 billion for 32 of

[3]The World Bank and International Monetary Fund consider a country to be "debt sustainable" if the ratio of a country's debt (in present value terms) to the value of its exports is 150 percent or less.

[4]Efforts to relieve the debt burdens of poor countries have concentrated on the external debt of these countries. Thus, debt sustainability is defined in terms of repaying debt owed to external creditors, with export earnings considered an important source of revenue for repaying this debt.

these countries. According to the World Bank and IMF, countries that receive debt relief under the HIPC initiative are projected to be debt sustainable. However, we found that the initiative is not likely to help recipients achieve debt sustainability because the World Bank and IMF assume that these countries will achieve export growth rates more than double their historical levels.[5]

Two key factors make it difficult for poor countries to achieve the high export growth rates assumed by the World Bank and IMF. First, most of the 10 countries we analyzed rely on one or two primary agricultural and/or mineral commodities for a significant portion of their foreign exchange earnings. However, the prices of these commodities have been on a downward trend in recent years, which impairs these countries' ability to increase their export income. Second, development professionals and multilateral aid organizations recognize that the HIV/AIDS pandemic is a major threat to the growth rates of many poor countries. The governments of these countries will need to divert funds from economic growth initiatives to cover dramatically increasing health care costs, rising labor costs, and productivity losses in key export sectors.

[5]See GAO-02-593 and United States General Accounting Office, *Developing Countries: Debt Relief Initiative for Poor Countries Faces Challenges*, GAO/NSIAD-00-161 (Washington, D.C., June 29, 2000).

Shifting Some Multilateral Loans to Grants Would Have a Positive Impact on Debt Sustainability for Poor Countries

Grants Can Help Some Countries Reach Debt Sustainability

A shift from loans to grants would benefit all countries' ability to repay their future debt. If grants were to replace 50 percent of loans, the debt-to-export ratios of all 10 countries we analyzed would improve (see table 1). Their debt-to-export ratios are projected to decline from an average of 432 percent under the historical baseline to an average of 235 percent under the 50-percent proposal. Under the historical baseline, only two countries—Mali and Mozambique—are debt sustainable. Two additional countries—Benin and Uganda—would become debt sustainable over the 20-year period under the 50-percent grants proposal. In addition, Nicaragua and Tanzania are either debt sustainable or nearly so for a considerable portion of the 20-year period under the grants proposal.

Table 1: Projected 20-Year Debt-to-Export Ratios under Three Scenarios

Country	Historical baseline (percent)	Impact of 50-percent grant proposal (percent)	Impact of full forgiveness of old multilateral debt (percent)
Benin	168	**99**	**142**
Bolivia	668	393	649
Burkina-Faso	713	377	648
Ethiopia	572	328	502
Mali	**62**	**42**	**44**
Mozambique	**153**	**78**	**140**
Nicaragua	377	*210*	358
Tanzania	434	*239*	429
Uganda	339	**125**	324
Zambia	837	457	784
Average	**432**	**235**	**402**

Note: Countries projected to be debt sustainable are in bold. That is, their debt-to-export ratio is near or below 150 percent. Countries that are nearly debt sustainable are in italics. GAO's projections of debt sustainability assume that countries receive debt relief under the HIPC initiative and grow at historical export growth rates.

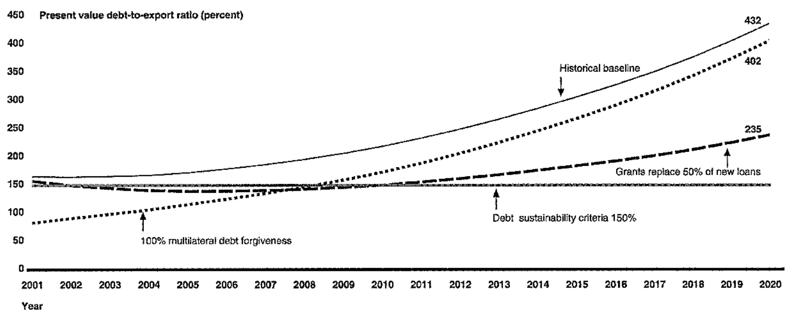
Source: GAO analysis.

The 50-percent grants proposal does not help every country become debt sustainable over the 20-year projection period, however. Based on our analysis, Bolivia, Burkina Faso, Ethiopia, and Zambia will not be debt sustainable at the end of the 20-year period, even if they receive 50 percent of their future assistance in the form of grants. The benefits from 50-percent grants are not sufficient to lessen the debt burdens of these four countries because they are projected to borrow substantial additional resources to compensate for insufficient revenue from exports.

Grants Proposal Contributes More to Debt Sustainability Than Full Forgiveness of Old Multilateral Debt

The grants proposal is also more effective in promoting debt sustainability than proposals to forgive 100-percent of old multilateral debt. Our analysis shows that debt-to-export ratios decline from an average of 402 percent under the 100-percent debt forgiveness scenario to an average of 235 percent under the 50-percent grants proposal. Long-term debt sustainability under 100-percent debt forgiveness is in fact only slightly improved over the historical baseline. Forgiveness of old multilateral debt would improve countries' debt ratios only for the first 7 years. After that, the advantage of this plan is eliminated because these countries are projected to accumulate a substantial amount of new debt that will quickly become unsustainable (see fig. 1).

Figure 1: 20-Year Debt Sustainability Projections for 10 Poor Countries



Note: The lines for the three scenarios represent the annual average debt ratios for the 10 countries.
Source: GAO analysis.

Grants Proposal Can Be Financed through Relatively Small Increases in Donor Contributions

Shift to 50-Percent Grants Would Reduce World Bank Concessional Resources

The proposal to shift 50 percent of multilateral loans to grants would result in a revenue loss to the World Bank. We estimate the present value of foregone repayments from poor countries to the World Bank to be approximately $9.73 billion over the next 40 years. The total financial loss of the 50-percent grants proposal is approximately $15.6 billion, since the $9.73 billion would have accrued an additional $5.82 billion in investment income to the World Bank. This amount represents about 8 percent of the $120.2 billion in present value terms that the World Bank expects to commit to poor countries over this 40-year time frame.

The World Bank has reported that the grants proposal would result in a $100 billion loss to IDA over 40 years—about $59 billion of this loss stems from foregone repayments, with the remaining $41 billion derived from foregone interest earnings. However, the World Bank's methodology assumes that the value of a dollar received today is worth the same as a dollar received 40 years from now. This assumption does not properly account for the impact of inflation and the investment income that could accrue over time.

Small Increases in Donor Contributions Can Finance the Grants Proposal

Our analysis shows that the 50-percent grants proposal could be fully financed through small increases in contributions from donor countries over what is currently projected. If donor countries were to increase their annual contribution to IDA by 1.6 percent over 40 years, they would fully finance the 50-percent grants proposal. An annual increase in donor contributions of 1.6 percent would be less than the expected rate of inflation, which is projected to be 2.3 percent over this time period. Donor contributions to IDA are expected to increase by 13.4 percent over the next 3 years, with U.S. contributions expected to grow by more than 18 percent.

Alternative options for making up the foregone revenue from the 50-percent grants proposal are fairly limited. The World Bank finances its concessional loan program through International Bank for Reconstruction and Development (IBRD) contributions, investment income, and loan repayments, in addition to donor contributions. The World Bank is unlikely to recoup the lost revenue from IBRD contributions because any increase in contributions to IDA from IBRD would come at the expense of other priorities such as maintaining sufficient reserves for lending to middle income countries. The World Bank would have difficulty significantly increasing its investment income without increasing the risk of its investments beyond what it considers prudent. Furthermore, it cannot increase loan repayments from poor countries without effectively nullifying any improvement to their debt sustainability that would accrue from the 50-percent grants proposal.

Mr. Chairman and Members of the Subcommittee, this concludes my prepared statement. I will be happy to answer any questions you or other Members may have.

Contacts and Acknowledgments

For addition information about this testimony, please contact Joseph Christoff at (202) 512-8979. Individuals making key contributions to this testimony included Thomas Melito, Anthony Moran, Bruce Kutnick, R.G. Steinman, Ming Chen, Jeffery Goebel, and Lynn Cothern.

The Testimony of Victor Miramontes

(Former Managing Director and CEO of The North American Development Bank)

Before

The Subcommittee on International Monetary Policy and Trade

of the

U.S. House Committee on Financial Services -

May 2, 2002 Hearing concerning the potential reform of the North American Development Bank's charter

Chairman Bereuter, members of the Committee, I thank you for the invitation to appear before you to discuss an issue that is of importance to me not only because of the time and energy I have invested in it professionally, but because of my personal history having grown up on the border in El Paso, Texas. It is an issue of great importance today in terms of the future economic growth and development of the U.S.-Mexico border region. That issue is the North American Development Bank, and the question of what new initiatives and reforms should be undertaken to ensure its continued success. This committee has posed a number of related questions that I will answer to the best of my ability.

Your first question relates to my experience at the Bank. I will address this question as it pertains to my experience with the Bank's policy and structural issues throughout my testimony. But my fundamental answer to this question is simple - I loved every minute of my tenure. I have never worked harder, with more unsolvable issues, or with greater political and financial uncertainty. My response comes from my being a part of the people and social fabric that make up this unique place in the world. The US-Mexico Border is by definition divided down the middle, yet its patriotic citizens, at times, see a greater divide with the rest of their own nation that doesn't seem to understand the day-to-day issues of the region. It is a region of many opposites and problems that ironically unite it more than divide it. It is a quickly growing family that knows it has a better future as it learns how to effectively exercise its intellectual, political and economic capabilities – in both countries.

I make reference above to the NADBank's "continued success" to clearly suggest to you that the NADBank has had successes thus far. It has had successes despite what I see as significant limitations in the way the institution was initially created. While we can point to the successes of the NADBank, the institution has not lived up to the high expectations with which it was established. The NAFTA political process left border communities with the expectation that the NADBank was created to address all of their community needs with a pool of $3 Billion in grants or, at least, in paid in capital. Others outside the border region expected the Bank to take over thorny issues and remove them from their own list of problems. There are a variety of other reasons for this, and I will offer my perspective on them.

So today I would like to begin by addressing the NADBank's successes thus far. I will also address what I see as the shortcomings of the institution's mandate. I will offer you my analysis as to why certain things about the NADBank have worked and why others have not, and will offer you my opinion on what types of new initiatives and reforms could help the NADBank become as effective an institution as possible.

First, the successes of the NADBank must be recognized. Today, there are an unprecedented number of projects underway along the U.S.-Mexico border. In the seven years since the creation of the NADBank and its sister institution, the Border Environment Cooperation Commission (BECC), 43 infrastructure projects have been approved for financing, representing a total of US$1.14 billion in infrastructure development. In the world of infrastructure development, this amount of work in a seven-year period is significant. Bear in mind that we are talking about $1 billion in projects in a narrow swath of land 200 km wide that includes some of the fastest growing and poorest communities in the United States and Mexico. You also need to put this in historical perspective – more projects have been delivered to both sides of this border region in the last 7 years than ever before. The NADBank to date has approved financing of US$379.1 million to support the development of these projects. In terms of infrastructure investment in the border region, a region that had been by and large neglected prior to the creation of the NADBank and the BECC, this is tremendous. As a result of this unprecedented level of investment in border infrastructure, some 6.1 million border residents are in the process of receiving adequate water, wastewater, and solid waste services where they did not have such services before. Thus, while I encourage this committee to make all the changes necessary to improve the NADBank and the BECC, please do not ignore or worse, inadvertently eliminate, the parts that do work.

The NADBank and the BECC have developed projects that are financially and environmentally sustainable. Both institutions have focused on the fundamentals of public governance, from local democratic openness to fiscal responsibility. The work of these institutions has been with a long-term vision to ensure that the ongoing operations and maintenance of these projects will remain adequate and affordable for the communities they serve. The Bank can point to its record with its Institutional Cooperation Development Program (IDP) and its Utility Management Institute (UMI). Just last week I attended a meeting in Mississippi where the Department of Health's water quality enforcement officer stated that a new law requires all rural water system board members to be trained on the fundamentals of system management and governance. In her opinion, it is a requirement that has truly improved the long-term viability of Mississippi's water systems and its public's health. These programs work. They aim to develop and enhance the institutional capacity of the utilities that must sustain the long-term operations and maintenance of the projects the Bank finances. In my opinion, this work is among the Bank's most important. The creditworthiness of the communities in which the Bank provides financing can only be enhanced long-term if there is a continued commitment to institutional development programs at the Bank.

As I mentioned, the NADBank is participating in the financing of these projects to the tune of US$379.1 million. Ninety-three percent, US$354.6 million, of this has been in the form of grant funds from the Bank's EPA-funded Border Environment Infrastructure Fund – a fund that I helped create in response to the Bank's inability to lend. The NADBank has only directly loaned US$23.53 million to date. This low level of direct lending has been the source of much of the criticism leveled against the NADBank, but this figure in and of itself is not an accurate performance measure. This grant-to-loan ratio is, however, indicative of the shortcomings of the Bank's original lending structure and mandate.

What we came to recognize at the NADBank as we began our work in 1995 is that the "bankability", in the traditional sense, of the projects we were charged with financing was very limited. Those communities that are on the U.S. side of the border have various financing options that are permanently more appealing than the market rate lending program the NADBank can offer. These include tax-exempt municipal bonds, and state revolving loan funds, both of which offered interest rates with which the NADBank lending program could not nor should not compete. At the same time, the vast majority of communities on both sides of the border with environmental infrastructure needs are non-investment grade communities that will never be able to afford to finance projects with any market interest rate loans.

Despite limitations on the lending side, the NADBank's primary grant making facility, the Border Environment Infrastructure Fund (BEIF) has had great demands upon it, and the creation of this fund by the Bank has facilitated significantly greater equity in distribution of the EPA's border funds. Prior to the establishment of the BEIF, EPA border infrastructure funding was focused primarily on a few large international wastewater treatment plants with limited public involvement. Today, to EPA's credit, BEIF funds assist project affordability of all sizes and locations throughout the border region, done in a manner that requires local public participation and governance. While the Bank's primary lending programs have failed to work, the creation of the Bank and the BECC truly improved EPA's ability to create, fund and manage border projects - an unintended, but very good consequence.

The adaptation that was made by the Bank was to function in many respects more as a development agency, relying on its grant making facilities to be the catalyst it has been to this unprecedented level of infrastructure development. One thing that the Bank has not done, however, as pointed out by San Antonio business writer David Hendricks, is to straddle communities with debt that they cannot afford to service. The financing packages the Bank has offered have been based on detailed affordability analyses, and have been agreed to under rate and operating covenants that grant recipient communities must keep in order to receive funding, aimed at ensuring the long-term financial viability of the projects. At the same time, the Bank has recognized that grant funding, by itself, can do more harm than good if it displaces local fiduciary responsibilities. A case-by-case balancing act must therefore be crafted for each community.

So, while we recognize the unprecedented level of infrastructure development initiated by the NADBank and the BECC, two realities exist: the first is that with only $US23.5 million in direct loans, the vast majority of the Bank's paid-in and callable capital remains unutilized; the second is that the environmental infrastructure needs of the U.S.-Mexico border region remain immense, estimated at about US$2 billion between now and 2005.

It is against this backdrop that the debate over reform and enhancement of the NADBank and the BECC has been initiated, culminating in the Monterrey Commitments agreed to by Presidents Fox and Bush on March 22 of this year. I will comment on these.

With regard to geographic expansion on the Mexican side of the border to 300 km from the existing 100km range, I believe it is a positive step toward broadening the reach of the Bank. I do not know the full details of the proposal, but I generally support it since many border problems actually originate in areas outside the 200 km zone. It is my understanding that preliminary demographic analyses by Bank staff indicate that this geographic expansion could make NADBank services available to approximately 5.6 million persons living in such communities as Monterrey, Hermosillo, and Saltillo. However, without additional changes to the Bank's charter I do not see this change alone making a sufficient difference in the Bank's lending capabilities.

A second reform proposal offered out of the Monterrey meetings has to do with replacing the two distinct governing boards of the BECC and the NADBank with a single board of directors with representation from the two federal governments, the Border States and the public. This is a viable proposal that could help enhance coordination between the two agencies. However, viewing such changes to the current structure of the NADBank and the BECC as having the potential for dramatically impacting the performance of the institutions, such as the Bank's ability to lend more, is incorrect. A single board would improve the institutions focus and coordination on issues that do not present local community conflicts with each institution's distinctive mission. The BECC must continue to provide a mechanism for open public discussion and development of environmental projects. The Bank must continue to provide the local fiscal and operational framework needed for a community project's long-term viability. The first process results in a demand for more federal and state funding and the latter process results in a demand for more local funding. This conflict is unavoidable and results in very real political pressure on elected officials at all levels, system operators and the BECC and the NADBank. A single board must ensure that it has the internal mechanisms to meet each institutions mission and yet appropriately separate the decisions that are inherently in conflict. A single board can meet this task if the issue of unavoidable conflicts is properly examined and planned for.

The structure and process of the NADBank and the BECC should be improved and a single board will greatly assist in this goal. However, the constraints under which the NADBank has operated have much more to do with the mandate of the institution, rather than simply its structure or process. If the ultimate expectation is for the NADBank to perform as a lending institution and use its capital to its full extent, the solutions lie in expanding its sectoral mandate within reasonable boundaries. This would entail transforming the NADBank into an <u>infrastructure</u> development bank with a broader mandate, covering <u>all</u> infrastructure projects and corridors that are relevant for the economic development of the border region, while ensuring that environmental infrastructure concerns continue to be the primary focus of the Bank. The Bank's mandate should be expanded, in my opinion, to include <u>any</u> infrastructure project that benefits the border. Since both governments are adequately represented on and control Bank's Board decisions, I would delegate the future decision as to which projects are appropriate to its Board of Directors. What may seem to be inappropriate today may be of critical need tomorrow. The Bank must be flexible enough to appropriately act, with full public participation, without having to amend the bi-lateral agreement again. While it is my belief that BECC certification should continue to be required for the Bank's environmental projects, certification of a wide range of other infrastructure projects is not appropriate. Since public funds are being used, the a unified Bank/BECC Board should only ensure that all non-environmental projects have an appropriate public process, but a project certification should not be required for the Bank's market rate loan funds to be accessed.

A second element of future growth and success of the Bank involves recognizing that environmental projects in most border communities will continue to require grants and technical assistance for years, before they are creditworthy. The Low Interest Rate Lending Facility (LIRLF) recently initiated by the Bank will help to make loans a practical option for many communities, but the Bank's *Five Year Outlook* shows that even that will not get the NADBank to fully use its current capital.

I believe it is worthwhile for this Committee and others that may assess the NADBank issue to study the experiences of all other multilateral development institutions in lending to environmental sectors. Not more than 7% of their portfolios are represented by such projects. This sector represents the entire universe of the NADBank, yet we expect it to be lending and fully utilizing its capital under such a narrow mandate. Ironically, the Bank's current lending represents 7% of its project funding activity, with the BEIF representing 93%.

At their inception the purpose of the NADBank and the BECC was to establish an institutional framework for helping both countries develop long-term solutions to the key infrastructure problems that stem from their expanding economic links. Preserving the capital of the NADBank and leveraging it in the markets is crucial to that effect. A more balanced and diverse portfolio is needed not for the Bank's sake, but for the rapidly growing population of the region.

These ideas are not new, nor do I claim exclusive ownership to them. Various analyses by individuals and groups who follow and work with the two institutions have reached similar conclusions. A proposal presented by the Mexican Government last summer expressed Mexico's need to fully use the Bank's capital and to respond to a broader range of infrastructure needs that are prevalent throughout the border region. A proposal presented jointly by the Texas Center for Policy Studies, the Willie Velasquez Institute and UCLA, and endorsed by the San Antonio Fee Trade Alliance also provides a reasonable framework for expansion of the Bank's scope and use of its capital, while preserving its key role regarding the environment. I would encourage the members of this Committee to examine these proposals and others as part of its work in considering NADBank/BECC reform.

In conclusion, let me say that I believe the reform proposal offered out of Monterrey is clearly a step in the right direction. However, broader reforms are necessary if the NADBank is to live up to its potential and fully utilize its capital. I will summarize the key points I believe both governments must consider as the debate on reform moves forward:

- Despite many obstacles and limitations, the NADBank/BECC experiment has worked. Issues of structure and process are important but secondary to the issue of mandate reforms in terms of improving effectiveness. Institutional reforms must not be disruptive to the current workloads of the institutions, which are growing by leaps and bounds in terms of the number of projects in the pipeline for development. Even as currently flawed, the NADBank and the BECC are providing needed services for communities that cannot afford to wait for a perfect solution.

- Grant funding, institutional development and technical assistance must remain key elements of the NADBank/BECC approach in order to foster the long-term operational sustainability and affordability of projects. Proper local governance and professional management of key public infrastructure is the only long-term solution – grant funding and technical training must leverage this outcome.

- Full utilization of the NADBank's capital will require further levels of mandate expansion into sectors outside the traditional environmental sectors, while maintaining environmental sectors as the primary mission of the institutions. Give the Bank's Board of Directors full discretion and flexibility on how this "open" infrastructure mandate is applied. A unified Board will ensure that the missions of both the Bank and the BECC are properly balanced as this mandate independence is exercised over time.

Again, thank you for this opportunity to address this committee as it considers this matter so important to the future of the U.S.-Mexico border region. I will be happy to answer any questions you may have.

David Hendricks: Confab players can learn from NADBank

San Antonio Express-News

Web Posted : 03/21/2002 12:00 AM

MONTERREY, Mexico — What's wrong with this picture?

The United Nations is holding its Conference on Financing for Development. The World Trade Organization is here. So are the World Bank, International Monetary Fund and Inter-American Development Bank.

Their goal? A plan to raise living standards in impoverished areas around the world.

The organization that ought to be here this week, but isn't in any visible way, is the San Antonio-based North American Development Bank, which finances water, sewage and landfill projects along the 2,000-mile U.S.-Mexico border.

NADBank's scope is minimal compared to most other development banks, which fund roads, education, utilities and health care initiatives on a scale ranging from regional to global.

Yet, NADBank can say something these other development banks cannot. It has not trapped a community or nation or region in debt it cannot repay.

Think about recent international monetary crises. Mexico in late 1994, East Asia in 1997, Russia in 1998, Ecuador, Ukraine, Pakistan, Turkey and finally Argentina in 2001 all were caught in the trap of debt to development banks at this Monterrey conference and to outside governments.

The debt loads end up crippling governments' capacities to sustain economic growth and to meet the social needs of their citizens.

What did NADBank do differently? It did its homework. It determined how much border residents could afford for utilities. Then it made a few, selective loans to places like Brawley, Calif., Ensenada, Mexico, and Ciudad Juárez, Mexico — cities with sufficient revenues to repay interest on top of regular utility rates.

NADBank took a lot of political heat for this. Millions of dollars were available to invest, but there was little to show for it.

NADBank managing directors like Victor Miramontes and Raul Rodriguez didn't blame anyone, though it was the bad U.S. Treasury bylaws that tied their hands. They made the best of a bad situation, but they did not do what their global development bank brethren did, which is weigh down populations with debt they could not escape.

Only last fall was NADBank allowed to offer part of its capital at interest rates below commercial-bank rates. It is still too soon to know how effective that is in a region where even zero-interest loans often are not affordable.

Still, NADBank has helped the impoverished border zone in a way that never had been achieved.

Frankly, this "sophisticated" U.N. conference appears devoid of this kind of experience. A herd of bank and non-profit organization bureaucrats are blathering about a lot of things that were dozens of moves ago for NADBank.

NADBank should have the chance to expand its mandate to enter new sectors like roads, health care, housing and education.

Yet, the Treasury Department seems insistent on treating NADBank like some sort of tar baby that should be done away with, a process starting with some kind of merger with its technical-advising sister institution, the Border Environmental Cooperation Commission based in Ciudad Juarez, Mexico.

I asked U.S. Treasury Secretary Paul O'Neill on Wednesday during a Monterrey press conference about NADBank's future, mentioning San Antonio's fear that the bank may dissolve or leave San Antonio.

"Presidents Bush and Fox will spend quite a bit of time together over the next two days, and we have been working with our counterparts in Mexico under instructions from the two presidents," O'Neill said.

"Their interest is in creating institutions that produce substantive results," he added. "I do not want to pre-empt the presidents, but staff-level work has been productive, and there will be steps to create an institution that makes real contributions."

What does that mean? Given the implicit criticism in his answer that NADBank has lacked results, O'Neill seemed to say changes are forthcoming. What they are is anyone's guess.

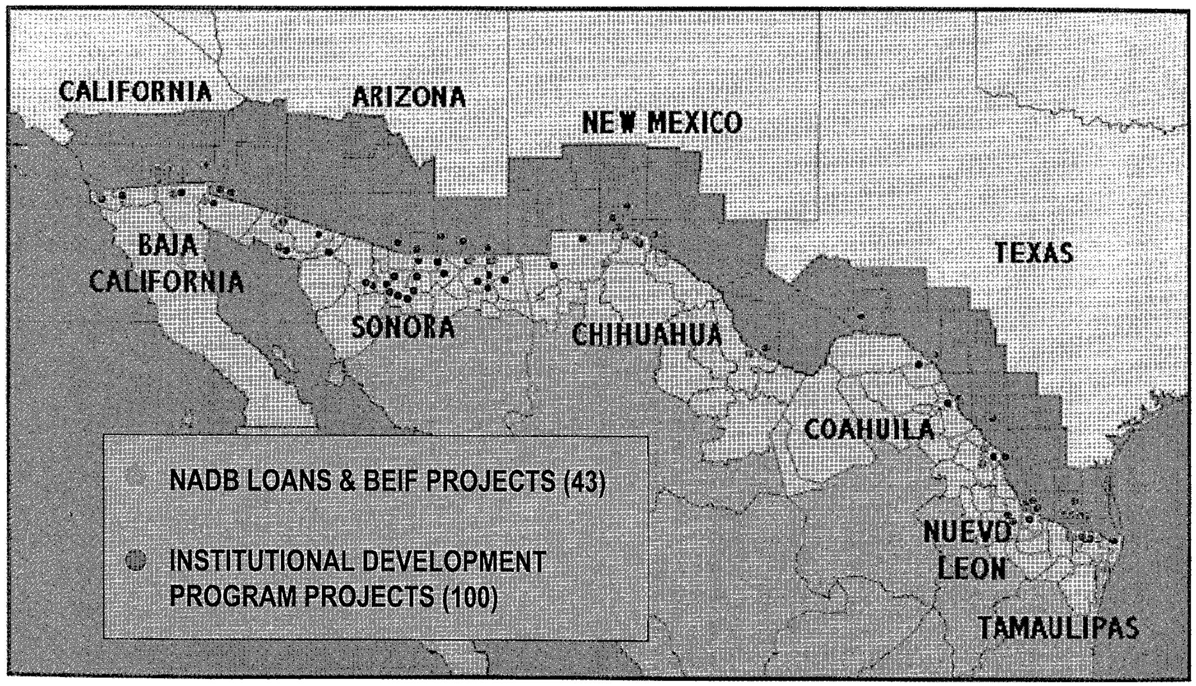
But NADBank, operating quietly in San Antonio, knows things this U.N. conference is struggling to learn: how to help people without the heavy yoke of debt.

dhendricks@express-news.net

03/21/2002

NADB PROJECTS

MARCH 2002



ANNEX I

NORTH AMERICAN DEVELOPMENT BANK
SUMMARY OF APPROVED FUNDING BY PROJECT
March 31, 2002

	Project	Type	Project Cost (US Dollars)	BEIF Amount (US Dollars)	Loan Amount (US Dollars)	SWEP Amount (US Dollars)
1	Agua Prieta, Sonora	SW	1,905,490	--	448,964	--
2	Alton, Texas	WW	14,476,621	259,396	--	--
3	Brawley, California (1)	W	24,900,000	--	972,329	--
4	Brawley, California (2)	W / WW	13,761,638	6,390,736	--	--
5	Calexico, California	W	11,330,000	6,477,320	--	--
6	Ciudad Acuña, Coahuila	WW	78,810,000	16,730,000	TBD	--
7	Ciudad Juarez, Chihuahua (1)	WW	31,490,000	12,188,000	4,640,474	--
8	Del Rio, Texas	W	44,630,000	15,180,704	--	--
9	Doña Ana County, New Mexico	WW	27,842,100	12,058,444	--	--
10	Donna, Texas	W / WW	21,617,000	2,607,365	--	--
11	Douglas, Arizona	W / WW	8,468,034	3,714,685	TBD	--
12	Eagle Pass, Texas	W / WW	105,344,092	17,994,097	--	--
13	El Paso, Texas (JRWTP)	W	37,822,343	14,906,458	--	--
14	El Paso, Texas (LVWD)	W / WW	100,350,600	17,500,000	--	--
15	El Sasabe, Sonora	WW	935,062	467,531	--	--
16	Fabens, Texas	W / WW	9,739,133	6,100,177	TBD	--
17	Heber, California (1)	WW	3,383,800	1,082,725	--	--
18	Heber, California (2)	W / WW	4,542,400	2,528,375	--	--
19	La Union, New Mexico	WW	7,273,050	4,769,444	--	--
20	Laredo, Texas	W / WW	21,581,262	6,231,450	--	--
21	Mercedes, Texas	W / WW	10,983,154	896,075	1,874,900	--
22	Mexicali, Baja California	WW	57,360,000	20,620,000	--	--
23	Naco, Sonora	W / WW	2,070,308	945,154	180,000	--
24	Nogales, Arizona	WW	74,395,974	59,504,955	--	--
25	Ojinaga, Chihuahua	SW	1,773,760	--	--	500,000
26	Piedras Negras, Coahuila	WW	56,820,000	8,400,000	TBD	--
27	Puerto Palomas, Chihuahua	WW	5,184,280	1,880,300	TBD	--
28	Puerto Peñasco, Sonora	SW	2,177,284	--	496,243	--
29	Raymondville, Texas	W	7,445,343	4,509,706	--	--
30	Region Cinco Manantiales, Coahuila	SW / WW	20,981,800	--	8,590,000	--
31	Reynosa, Tamaulipas	WW	83,400,000	33,500,000	TBD	--
32	Roma, Texas	W / WW	34,177,640	5,572,450	--	--
33	Salem/Ogaz, New Mexico	WW	2,818,501	991,912	--	--
34	Sanderson, Texas	WW	3,638,099	352,042	--	--
35	San Diego, California	WW	99,588,000	17,202,462	--	--
36	San Luis Rio Colorado, Sonora (1)	WW	13,700,547	5,935,545	TBD	--
37	Somerton, Arizona	W	3,436,791	1,069,823	--	--
38	Tecate, Baja California	W / WW	8,237,671	3,718,780	TBD	--
39	Texas Plan (Hook-ups)	W / WW	8,820,000	6,356,700	--	--
40	Tijuana, Baja California (1)	WW	27,430,000	16,000,000	6,320,000	--
41	Tijuana, Baja California (2)	WW	42,014,408	18,007,204	TBD	--
42	Uvalde, Texas	SW	3,415,000	--	--	500,000
43	Westmorland, California	WW	4,607,220	1,977,500	--	--
	TOTAL APPROVED TO DATE:		**1,144,678,405**	**354,627,515**	**23,522,910**	**1,000,000**

W = Water
WW = Wastewater
SW = Solid Waste

Statement by Ernesto S. Silva
City Manager, Mercedes, Texas

before the

Subcommittee on International Monetary Policy and Trade
of the Committee on Financial Services
U.S. House of Representatives

May 2, 2002

Chairman Bereuter, Ranking Member Sanders, members of the subcommittee, it is an honor to have the opportunity to testify before you on the relationship between local communities and the North American Development Bank (NADBank) and its sister institution, the Border Environmental Cooperation Commission (BECC). As you requested, I will also comment on the Bush Administration efforts to improve performance of both institutions and their proposed merger.

Introduction

The City of Mercedes is a small rural community located along the U.S.-Mexico border in South Texas and has approximately 14,000 residents of whom 52% of the population lives in poverty. The community has an unemployment rate of over 16% with a per capita income of $5,237 and the average home value is $29,500. From the demographics, a person can conclude the City of Mercedes is a distressed community like those typically found along the U.S.-Mexico border. Mercedes also has a high dropout rate, limited health care services, limited employment opportunities, deteriorated infrastructure, and limited resources to address these issues.

The City of Mercedes, like many other border communities in the State of Texas, lacks the necessary infrastructure to provide basic utility services to its residents and others living in its extra-territorial jurisdiction. According to the Texas Water Development Board, there are 30 colonias in the Mercedes area with a combined population of over 8,000. Due to the lack of proper planning and lack of financial resources, the City of Mercedes in the late 1980's found itself struggling to provide basic utility services to its customers. The devaluation of the Mexican peso, two severe freezes and diminishing employment opportunities in the agricultural and textile industries were some of the factors that contributed to the distress of the community. Many have argued the military base closings from 1950 to 1975 in the Rio Grande Valley were the initial factors to negatively impact Mercedes.

In 1991 the Texas Water Development Board (TWDB) introduced the Economically Distressed Areas Program (EDAP) to cities and rural water supply corporations to construct water and sewer projects in South Texas colonias. The EDAP provided loans and grants to communities, and funding was dependent on two factors; a community's capability to provide water and sewer services to colonias and its ability to borrow money. The program was supposed to bring water and sewer services to colonia residents who were living in "Third World Conditions", while providing a community the ability to increase its water and wastewater treatment capacity. Ironically, the program created animosity between residents living in Mercedes and those residents living in colonias. The EDAP initiative failed to provide funding for cities to upgrade their existing infrastructure for future growth, and did not allow for cities to utilize grant funds to replace their deteriorated distribution and collection systems. Community stakeholders were quick to inform the elected officials of their unwillingness to pay for utility improvements in colonias because those residents did not pay city taxes. The end result has been a slow moving program that on average takes five years to receive any funding. Thus the EDAP initiative created a demand for financing from the NADBank. Unlike the NADBank, the TWDB does not conduct a comprehensive review of a city's financials or utility infrastructure prior to accepting a city's facilities plan, since it only addresses the needs of colonias.

NADBank Experience

In 1996 the City of Mercedes was the first community to receive funding from the North American Development Bank. After receiving a $6.2 million grant from the Texas Water Development Board, the city applied to other Federal agencies to leverage the funding received from the TWDB. The city received a $1.6 million grant from the Economic Development Administration, a $1.3 million grant from the Rio Grande Valley Empowerment Zone and $1.6 million loan from the NADBank. The City was forced to sell $1.8 million in revenue bonds to fulfill the loan portion of the EDAP project that the NADBank agreed to loan. The NADBank loan proceeds remained with the city from 1996-1999 until the city decided to refund the bonds and sell bonds on the open market at an interest rate of 4.5%. Due to the lack of financial knowledge at the local level, the NADBank had unintentionally caused the city to sell bonds prematurely at a high interest rate of 9%. Also the city had made payments for 2 years without initiating construction.

In an effort to rectify the situation, the NADBank and the city held a series of highly productive meetings to discuss what solutions were available. The following programs were recommended:

Institutional Development Plan

Recommendation	Program	Cost
• Upgrade the City's Financial Management System	RGV Empowerment Zone	$250,000
• Conduct Water & Sewer Rate Study	NADBank	$ 30,000
• Conduct Sanitation Rate Study	NADBank	$ 18,000
• Conduct Inflow & Infiltration Study	NADBank	$120,000
• Establish Debt Service Reserve	NADBank-Transition Asst.	$450,000
• Establish Repair & Replacement Reserve	NADBank-Transition Asst.	$250,000
• Implement a Water Meter Replacement Program	NADBank/City	$850,000
• Adopt a Water & Wastewater Facility Plan	BECC/City	$190,000
• Adopt a 5 year Capital Improvement Plan	City	$ 50,000
• Adopt a 7 year Operational Budget	City	-0-
• Adopt a 7 year Water & Sewer Rate Increase Policy	City	-0-

The total cost to undertake the institutional development plan was $2,178,000. The RGV Empowerment Zone provided $250,000 and the NADBank provided $1,178,000. The City of Mercedes participated with $750,000. The institutional development plan resulted in a comprehensive understanding of how the city's Utility System was functioning. The city also sent its Utility and Finance personnel to the NADBank's Utility Management Institute training program in San Antonio, Texas. This comprehensive approach deviated from the original approach utilized by the BECC and NADBank. Historically, the BECC certified a city's engineering facilities plan that identified the infrastructural needs of the community and the NADBank reviewed the plan for funding availability. The institutional development plan for Mercedes guaranteed the NADBank the City of Mercedes would have the ability to become self-sufficient if projects identified in the engineering plan were funded.

Although the institutional development plan process identified an additional $12 million in utility projects for the City of Mercedes, it provided the city with the understanding of how to finance the $12 million in projects while taking into account the city's five year capital improvements plan, operational costs, and annual debt service.

Bush/Fox Plan

The proposed Bush/Fox Reform Plan to extend the 100km inland to 300km would only impact Mexico. There should be a minimal amount of concern over the additional 200km and the impact it will have on existing projects. For communities in Mexico, the NADBank is probably the only option available to fund their projects due to the high interest rates in Mexico. However, American cities would still have the opportunity to apply for funding from other State and Federal agencies.

If the NADBank will be a viable option for American communities, it must have greater financial flexibility to increase the availability of grants to communities. The NADBank should increase funding for its Institutional Development Program and provide grants to those communities who undertake a comprehensive approach to resolve their infrastructural needs. An institutional development plan should be a requirement by NADBank for those who wish to apply for BECC certification. Financing provided by the NADBank should be at or below market rates; otherwise, NADBank financing for American cities is not a viable option.

After closely considering the impact the merging of the BECC and NADBank would have on our communities, I am reminded of the problems cities have faced when applying for funding from the Texas Water Development Board. It is imperative for the Congressional Leadership to understand that financing and engineering do not mix. The merging of these two agencies would create a much larger bureaucratic process that would ultimately fail our communities. From a personal prospective as a manager and operator of a municipal utility system, the BECC should be utilized to review projects for their engineering merits. The NADBank should be utilized to finance projects identified in a community's facility plan. If a community undertakes the institutional development process identified earlier, the BECC would be able to review and certify projects for local communities more effectively. A priority for the BECC and NADBank along with State and other Federal agencies should be to adopt a standardized procurement process. Another priority should be for state and federal agencies to standardize an acceptable engineering facility plan. The NADBank should be involved in the cost analysis and value engineering of a facilities plan. The local community should be allowed to draw on approved funding once the project is under construction. The role of the BECC should be to monitor the construction and the role of the NADBank should be to monitor the financing. This Congressional Leadership should review the procedures utilized by HUD and EDA for better examples of procurement and financing systems.

The plan by President Bush and President Fox to expand the role of the BECC and NADBank to include private initiatives is important and should be given careful consideration. Expanding the role of the BECC and NADBank to provide funding for preventive programs instead of reactionary ones is key. Some of the most pressing issues facing both countries are health care, transportation and waste disposal. If we continue to provide funding for current programs that address only issues facing cities today, we will never have a comprehensive transformation of our borders. We must address health care issues, especially when we consider germs and diseases have no borders and the Rio Grande River provides drinking water for all cities along its winding path. Financing international crossing to minimize the impact international bridges have on our environment and urbanized centers is another important issue. The NADBank should fund international trade corridors to safely move goods and hazardous waste between both countries without threatening families living in local communities. Finally, the NADBank should fund private sector initiatives addressing disposal of solid waste and hazardous waste.

NADBank Programs

If adopted by Congress, institutional development programs like the one identified earlier, should not require BECC certification. Only projects identified in the NADBank funded facilities plan would require BECC certification. By strengthening the institutional development programs, the BECC would actually receive facilities plans which would give them the ability to make decisions with the understanding NADBank has reviewed the city's finances and the city has adopted a financing plan to address the projects identified in the facilities plan. Furthermore, the institutional development program provides the public due process by working together with the NADBank and its public participation requirements. Local stakeholders would be given the opportunity to comment on projects identified in the facilities plan and reduce the amount of political fallout for both agencies. Presently, facilities plans are approved by the BECC thus placing NADBank in a position of having to fund projects that are not financially sustainable. For the same reasons, projects have been certified by the BECC, and approved by the NADBank that are still sitting on the shelves.

NADBank/ BECC Reform

In closing, I would urge the Congressional Leadership to strengthen the institutional development programs in order to provide a comprehensive approach to the water and wastewater issues facing our communities. These programs would be the NADBank pre-requisite before a city can submit a request to the BECC for certification. Only projects identified in the NADBank funded facilities plan would be eligible for funding. Both the BECC and NADBank should remain independent of each other but provide services in their field of expertise. We should not create a single Board for both agencies; otherwise there will be tremendous political pressure on the Board to fund projects that are not financially feasible. Finally, the BECC and the NADBank must be given the financial resources and tools to implement their programs. The amount of red tape after a project is certified and financed must be reduced, grant programs should be expanded and a clear vision must be adopted by Congress.

Free Trade Alliance San Antonio
Policy Statement Regarding Reform of the North American Development Bank (NADB) and the Border Environment Cooperation Commission (BECC)

In its capacity as an advocacy organization on issues of international trade, commerce and development, Free Trade Alliance San Antonio has followed the North American Development Bank (NADB) and its sister institution, the Border Environment Cooperation Commission (BECC), since inception. Free Trade Alliance San Antonio recognizes and appreciates the complexity of the challenges that these institutions have faced as they have worked to improve the lives of border residents.

In accordance with the joint recommendation of Presidents Bush and Fox in the fall of 2001, an initial examination regarding the performance and progress of the NADB and the BECC was implemented. Despite many organizational constraints, these institutions have made significant strides since their establishment. More environmental projects are presently under construction at in the border region than ever before, resulting in an improvement of the quality of life of millions of border residents.

Free Trade Alliance San Antonio is pleased that in their recent meeting in Monterrey, Mexico, Presidents Bush and Fox reached an accord and made recommendations to improve and strengthen the NADB and the BECC.

Free Trade Alliance San Antonio strongly supports the Presidents' pledge and acknowledgement of the following:

- The initiation of a comprehensive business process review of both institutions to identify ways to streamline and implement infrastructure projects.
- A recognition that a combination of grants and low-interest-rate loans is needed in order to assist poor communities' infrastructure needs
- A gradual and reasonable expansion of the geographic scope in Mexico.
- The decision to keep the NADB in San Antonio, as confirmed by Mexico's Foreign Affairs Secretary Jorge Castañeda.

These are important steps toward ensuring that these institutions continue to bring much needed improvements to this region. However, there are still key issues that have not been addressed regarding the overall reform of these institutions. We hope that the states, border communities and other stakeholders in the border region continue to have a voice in this process. Among the ways that this may be accomplished is through careful development of the scope of work for the business process review.

Free Trade Alliance San Antonio recommends that the following issues be given careful consideration in designing the scope of work for this process:

1. Procedural Issues between NADB and BECC

Among the criticisms of the NADB/BECC process is that there often exists a lack of coordination between the two institutions, as well as a duplication of services. These problems can often result in unnecessary project delays and costs for project sponsors.

> **Recommendation: At the core of any comprehensive business process review must be a careful and thorough evaluation of the NADB's and BECC's respective roles and responsibilities in the areas of project planning and design, development, and technical assistance.**

2. Impact of Single Board Proposal on Top Level Involvement in Institutional Matters and on Public Participation

The proposal to create a single board of directors should be implemented in a way that provides representation from all relevant constituencies. This should be addressed early in the implementation process in order to ensure the success of this proposal.

> **Recommendation: The business process review should look carefully at the impact of the proposal for a single board of directors, and offer recommendations to ensure successful implementation. Specifically, the creation of a single board should seek to achieve (a) improved coordination of policy and project development and implementation; (b) active participation of high-level public officials of both countries in board affairs; and (c) a balance between efficiency and participation by all relevant constituencies.**

3. Stakeholder Involvement in Business Process Review

The various groups involved in NADB/BECC issues will expect to have some level of involvement in crafting both the scope of work for the review, as well as further reform recommendations as a result of the findings of the review.

> **Recommendation: In order to assure support of the business process review by stakeholder groups and other interested parties, a strategy for involvement of the various groups is necessary. Among the stakeholder groups for consideration are:**

- **Congresses of the U.S. and Mexico**
- **Communities**
- **Environmental organizations**
- **Public policy institutions**
- **Border state governors**

Additionally, the terms of reference for the business process review should be made available for public comment.

4. Mandate Expansion

The reform proposal agreed to by both governments provides for expansion of the geographic mandate of the NADB in Mexico to 300 km from the border. Details are still pending regarding which NADB programs will be available in the expanded region in order to render effective this geographic expansion. While there was no apparent discussion in Monterrey regarding expansion of the NADB's sectoral mandate, various constituencies in both the U.S. and Mexico have advocated for NADB mandate expansion beyond the traditional environmental sectors as a way to deal with a broader range of relevant needs, and to make better use of NADB resources and potential. On March 19, 2002, the Mexican Congress unanimously expressed the need to provide the NADB with greater sectoral flexibility in its mandate, thus allowing it to address a broader range of urgent infrastructure needs while using its capital to a greater extent.

> **Recommendation:** **The business process review should include a careful analysis of the impact of the NADB's limited sectoral mandate on its ability to maximize the use of its paid-in capital. This analysis should include a review of the experiences had by other multilateral development institutions (i.e. the World Bank, the Inter-American Development Bank) in financing environmental infrastructure projects.**

Free Trade Alliance San Antonio commends Presidents Bush and Fox for their continued commitment to addressing the development needs of the U.S.-Mexico border region. Since taking office, both Presidents have shown a dedication to the issues affecting the border region. Both Presidents have set the U.S.-Mexico border region as a priority item on their agendas.

Free Trade Alliance San Antonio will continue to follow the issue of NADB/BECC reform, and hopes that the implementation of these reforms will result in more effective institutions to the benefit of the residents of both the United States and Mexico.

WRITTEN TESTIMONY OF
EDWARD D. GARZA
MAYOR OF THE CITY SAN ANTONIO, TEXAS

SUBMITTED TO

THE UNITED STATES HOUSE OF REPRESENTATIVES

COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON INTERNATIONAL MONETARY POLICY AND TRADE

2128 RAYBURN HOUSE OFFICE BUILDING

THURSDAY, MAY 2, 2002

CONCERNING

THE NORTH AMERICAN DEVELOPMENT BANK

Chairman Oxley, Ranking Member LaFalce and Members of the Committee:

My name is Edward D. Garza, Mayor of the City of San Antonio, Texas. I appreciate the opportunity to share with the Committee my written remarks concerning the North American Development Bank (NADBank) and my perspectives on the North American Free Trade Agreement's (NAFTA) impact on the City of San Antonio. I also want to thank my hometown Congressman, Charlie Gonzalez, for facilitating the submission of my remarks today.

The entire community of San Antonio has long supported and worked hard to promote trade between Mexico and the United States. The key to trade is infrastructure and the North American Development Bank is key to the improvement of this infrastructure.

In the early 1990's the entire community of San Antonio pulled together and fought an uphill battle in support of NAFTA. We did this with the knowledge that infrastructure improvement was key to the issue of trade.

One of the results of NAFTA was the creation of the NADBank in San Antonio and its sister institution the Border Environment Cooperation Commission (BECC) in Ciudad Juarez. We are all aware of the challenges facing all new institutions as they grow and mature. These two organizations are facing challenges today. It is vital that we support them.

The City provided the Bank with temporary office space and later, a permanent home at the City's International Center – a renovation project of the former city library - with the NADBank as its anchor tenant. This was an $11 million investment by San Antonio to support the NADBank. In fact, the City continues to provide the NADBank this office space rent-free.

When it was suggested that the NADBank and the BECC should merge, Governor Perry and the Governors of New Mexico, Arizona and California spoke out against this move. The City of San Antonio agrees with Governor Perry. NADBank should continue to serve the border region from its current location.

In addition, during a meeting with President Fox last fall, I expressed a strong commitment to his vision to increase the mandate of the North American Development Bank to better serve the border.

In February, I, along with several City Council members and our City Manager traveled to Washington D.C. and spoke with our Congressional Delegation on this issue. We strongly encouraged the Bush Administration and Congress to maintain the NADBank and the BECC as separate entities. We also support an audit of both institutions to identify where efficiencies should be improved.

The City supports an increase in the number of infrastructure projects in the border region. Also, the City supports the expansion of the geographic area served by the NADBank. It remains a strong priority of the City of San Antonio's federal initiatives program. With an International Airport, currently under expansion, and our redevelopment efforts with Kelly/USA, San Antonio stands at the center of trade in North American. There are over 700 companies in

San Antonio actively engaged in import/export activities with countries worldwide. These companies have created 20,000 jobs in the San Antonio region that are directly or indirectly tied to import/export related activities. Of these 700 companies, 633 companies are actively involved in import/export activities with Mexico. In fact, over 50% of total U.S.-Mexico Trade flows through the city of San Antonio. Last year, approximately $124 billion worth of trade-related products traveled across our city's highways and railroads.

NAFTA related trade has and will continue to grow and cause municipalities to assess their infrastructure needs. The role of NADBank in San Antonio will also need to be broadened to meet these infrastructure challenges. With assistance from this Committee and the Congress as a whole, San Antonio will continue to be a leader in trade. The City looks forward to working with Congress to address the infrastructure needs of the border region.

SAN ANTONIO **HISPANIC CHAMBER** OF COMMERCE

To: **SAHCC Board of Directors**

From: **SAHCC Governmental Affairs Committee**

Subject: **North American Development Bank and the Border Environmental Cooperation Commission**

Status: **Adopted** **Date: December 12, 2001**

Recommendation:

That the Board of Directors of The San Antonio Hispanic Chamber of Commerce adopts the following statement as policy:

Statement:

The San Antonio Hispanic Chamber of Commerce strongly urges the U.S. Department of Treasury and the Mexican treasury to keep the Border Environmental Cooperation Commission (BECC) and the North American Development Bank (NADBank) as separate entities, to strengthen the NADBank's institutional structure and continue its presence in San Antonio, Texas.

Furthermore, the Hispanic Chamber encourages the United States and Mexico to, as quickly as possible:

- adopt the goals of three inter-related reform proposals as outlined in the August 9, 2001 independent report prepared by the North American Integration and Development Center at UCLA, Texas Center for Policy Studies and the William C. Velasquez Institute – "Finding Common Ground: A Public Interest Proposal for BECC/NADBANK Reform" and endorsed by the Free Trade Alliance San Antonio.
- work toward effective expansion of NADBank's sectoral flexibility and geographic mandate to maximize its lending potential.

Background:

The North American Development Bank (NADBank) and its sister institution, the Border Environment Cooperation Commission (BECC), were created under the auspices of the North American Free Trade Agreement (NAFTA). The NADBank operates under the November 1993 *Agreement Between the Government of the United States of America and the Government of the United Mexican States Concerning the Establishment of a Border Environment Cooperation Commission and a North American Development Bank.*

The NADBank, established in San Antonio, is an international financial institution created and capitalized in equal parts by the United States and Mexico for the purpose of financing environmental infrastructure projects. All NADBank-financed environmental projects must be certified by the Border Environment Cooperation Commission (BECC), be related to potable water supply, wastewater treatment or municipal solid waste management and be located within the border region.

Several key principles were at the heart of the BECC and NADBank's creation during the NAFTA debate. These principles, which remain of critical importance, include:

- guaranteeing accountability, transparency, and wise use of public funds available to the BECC and NADBank
- ensuring the public and communities that benefit from or are affected by proposed projects have full access to information and an opportunity to comment on the project before certification and financing decisions are made
- using the limited available resources for projects that benefit the public, improve the quality of life in the border region and promote sustainable development
- ensuring that the institutions have a fully bi-national character

In summary, the NADBank's mission is to serve as a bi-national partner and catalyst in communities along the U.S.-Mexico border in order to enhance the affordability, financing, long-term development and effective operation of infrastructure that promotes a clean, healthy environment for the citizens of the region.

The region in which the bank focuses its efforts, as defined in its charter, is the area within 100 kilometers (approximately 62 miles) north and south of the boundary between the United States and Mexico. Spanning 2,100 miles from the Gulf of Mexico to the Pacific Ocean, the border region includes territory in the four U.S. states of Texas, New Mexico, Arizona and California and in the six Mexican states of Tamaulipas, Nuevo Leon, Coahuila, Chihuahua, Sonora and Baja California.

Over the last several months, there has been considerable discussion of the performance and roles of the BECC and NADBank. Specifically, the criticism stems from the concerns that the BECC and NADBank process takes too long to start projects and merging the two would streamline the process. The BECC is based in Ciudad Juarez, Mexico and it certifies projects for NADBank consideration and financing. Nevertheless, it is important to acknowledge that the creation of the BECC and NADBank was an unprecedented event for the U.S. and Mexico. Therefore, the original agreement creating the two entities does have some shortcomings that must be addressed. While many of the most serious issues have been resolved and continued reform is necessary, it must also be recognized that much progress has been made. In six years of operations, NADBank has approved at least 35 projects benefiting 42 communities, amounting to $324 million, most of which has come from EPA grants in addition to loans.

The North American Integration and Development Center at UCLA, Texas Center for Policy Studies and the William C. Velasquez Institute published a proposal for reform entitled, "Finding Common Ground: A Public Interest Proposal for BECC/NADBANK Reform", outlining several changes needed to allow the NADBank to reach its full potential as the full-scale development bank NAFTA needs. This proposal is endorsed by the Free Trade Alliance San Antonio.

The inter-related reform proposals are offered for consideration by both the U.S. and Mexico - with an eye toward accomplishing three over-arching goals:

- maintaining the promise of NAFTA to improve the public health, environment and living conditions along the U.S./Mexico border
- opening the possibility of creating a broader "development bank" to foster North American economic integration
- boosting community and economic development in those regions of Mexico where lack of opportunity has forced people to leave their homes and look for work elsewhere, including Mexico City, the border region and the U.S.

Texas Governor Rick Perry, speaking at a Western Governors Association conference held in El Paso, Texas during December 2001, went on record to oppose the proposed merger and is working with three other U.S. border governors to fight the idea. Governor Perry and the other border governors are urging that the U.S. Treasury and the Mexican treasury conduct an audit to uncover any problems and clearly identify the functions of the two institutions before any merger is decided.

The NADBank board consists of Treasury officials from both nations, as well as representatives of the U.S. State Department, the Environmental Protection Agency and the Mexican cabinet offices of the secretaries of the Economy and Social Development. At the time of this report, a private morning board meeting is scheduled to take place in San Antonio, Texas on Thursday, October 13, 2001 to be followed by a 2:30 p.m. press conference and a 3 p.m. public meeting at the University of Texas at San Antonio's downtown campus.

Pro –

1. The NADBank is one of San Antonio's most important institutions and is an excellent example of the bi-national cooperation essential for positive and productive economic integration of North America in coming years.
2. Expansion and reform of the NADBank can be accomplished relatively quickly, with minimal additional funding, and with near-term benefits realized on both sides of the border.
3. Reforming the NADBank's existing institutional structure and effectiveness as a lender, will better serve the communities the bank was created to help.
4. Reforming the NADBank will allow it to begin its transformation into the full-scale development bank the NAFTA needs.

Con –

1. Merging the BECC and NADBank into a new infrastructure fund and decreasing its interest rates, will make little difference when the goal is to access the $3 billion potential lending capacity the bank has.
2. Merging the BECC and NADBank could require re-authorization and re-appropriation of the bank's funds by both the U.S. Congress and Mexican government, both now operating in very tight budgetary circumstances.
3. The suggestion to locate any newly created institution out of San Antonio will be opposed by city, county, state and federal leaders.
4. The proposal to merge BECC and NADBank into a new border infrastructure "fund" and not a "bank" will violate the spirit of NAFTA's intention of creating a broader "development bank" to foster economic integration.

Implementation:

The San Antonio Hispanic Chamber of Commerce will communicate this position through public testimony to the North American Development Bank's Board of Directors at its Annual Meeting.

In addition, the Chamber will communicate this policy statement through written and public commentary to our elected State of Texas and U.S. officials and to any U.S. Government agencies with operating authority over the BECC and NADBank.

Finally, we will communicate this position to members of the media as well as the Chamber membership through its press releases, newsletters and weekly brief.

Order Code RL31136

CRS Report for Congress

World Bank: IDA Loans or IDA Grants?

Updated February 8, 2002

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Congressional Research Service

Prepared for Members and Committees of Congress

World Bank: IDA Loans or IDA Grants?

Summary

On July 17, 2001, President Bush proposed that the World Bank implement a plan where half of all its assistance to the world's poorest countries would be grants rather than low-interest loans. He said this would enable the Bank increase its levels of assistance for education, health, and other programs aimed at poverty alleviation. It would also keep poor countries from falling further into debt. The increased funding would be tied, he said, to clear and measurable results. The International Development Association (IDA) is the part of the Bank that currently makes low-cost loans (long repayment periods, very low service charge) to poor countries. IDA loans are funded with money contributed annually by donor countries.

Although there has been widespread support for the concept of IDA grants among other donors, multilateral agencies, and the public, many have indicated that they prefer a much smaller program than the President has proposed. Many are concerned about the long-term financial impact a large grant program might have on IDA. IDA funds a substantial portion of its new lending (40% of all commitments planned during the period 1999-2001) with repayments from prior loans. (These are often called "reflows".) Over time, if reflows are not available to help cover the cost of future IDA assistance, the cost of the World Bank's concessional aid program to poor countries will gradually rise. The President did not indicate, in his original proposal, that the Administration would support increased funding for IDA to help support the cost of new grants. In December, the Administration said it would be willing to raise the U.S. contribution level by up to 18% if certain institutional changes were made in the World Bank, but it did not link the projected increase to the issue of grants. Some people are concerned that the grant proposal is ultimately a plan to "defund" the World Bank, to bring about the ultimate termination of IDA either because it is too costly to donors or because it does not have sufficient funds.

In 2000, a congressionally-appointed study panel, the Meltzer Commission, made several proposals to replace World Bank IDA loans with grants. One of these would create a large grant program (funded with new contributions) to address poverty alleviation and policy reform issues. A second proposal, though, would basically dissolve the World Bank and use its residual assets to fund a special program – at no cost to anyone – addressing global needs. Many of those with reservations about the President's proposal hear echos of the Meltzer Commission's recommendation – particularly the second recommendation – in his grant plan.

The issue is being negotiated in the series of talks currently taking place on terms for a new replenishment (IDA 13) of IDA resources. In the foreseeable future, the costs and the benefits from a 50% grant program are not dramatically different than those available from the present IDA program. Most of the costs and benefits occur thirty to forty years hence, in a context which may or may not be similar to that faced by developing countries today. Some analysts believe that the underlying controversy may be less about IDA finances and more about influence in the international financial institutions. Should the Europeans develop a common policy front on IFI matters (as they have in this case), they will be the "largest single member country" and their leadership role will be substantially enhanced.

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Bush's Proposal and the Response

On July 17, 2001, prior to his trip to Genoa for a meeting with the top leaders of the seven leading industrial countries (G-7), President George W. Bush called on the World Bank and other multilateral development banks (MDBs) to provide a major share of their assistance to poor countries in the form of grants rather than low-cost loans. Speaking before several hundred World Bank employees, Bush claimed that his plan would help poor countries without adding to their heavy burden of debt. "I propose," he said, "that up to 50 percent of the funds provided by the development banks to the poorest countries be provided as grants for education, health, nutrition, water supply, sanitation, and other human needs." This would be, he said, compassionate conservatism at the international level. Alluding to protestors who have been calling for a major cancellation of debt owed by poor countries, the President said that his proposal "doesn't merely 'drop the debt' – it helps stop the debt." The increased funding would be tied, the President said, to clear and measurable results. [1]

The White House noted later that the President sought to convert to grants half the money the Bank lends to poor countries annually through its concessional loan facility, the International Development Association (IDA). A few countries borrow both from IDA and from the Bank's regular loan window, the International Bank for Reconstruction and Development (IBRD). Because these "blend" countries would not be eligible for grants, the President's plan would actually involve only about 40% of total IDA funding.

A grant program would have clear benefits, the Administration argued, for economic development and long-run poverty reduction. Besides, spokesmen said, a grant program would allow better assessments ex-ante of project effectiveness. Grants could be tied to clear and measurable policy instruments, to require more prior commitment to achievement of program goals and to link the actual payment of the grant to clear ex-post output measures.[2] The Administration did not explain at

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[1] Quoted in Michael Phillips, "Bush Wants World Bank to Make Grants–Switching from Loans has Large Catch if U.S. Fails to Boost Contributions." *Wall Street Journal*. (July 17, 2001), p. A2. For the full text, see George W. Bush, "Remarks by the President to the World Bank," Washington, D.C. July 17, 2001. Available from the White House web site at [http://whitehouse.cov/news/releases/2001/07/20010717-2.htm]

[2] White House. (2001) "Fact Sheet on U.S. Proposal to Increase World Bank Grants to the Poorest Countries."*U.S. Newswire* (Washington) July 20, 2001. The U.S. Treasury (continued...)

the time what the President meant by the comment that grant aid should be tied to ex-ante assessments or that the payment of the grant should be linked to ex-post output measures.

The President's summit colleagues had little comment on his proposal. The G-8 called on the World Bank and other MDBs to take further steps to help poor countries.[3] They did not mention, however, the issue of IDA grants. In a separate communique, the G-7 countries – the major MDB donor countries comprising the G-8 less Russia – said that they might be willing to discuss the concept further. "We support a meaningful replenishment of IDA and, in that context, we will explore the increased use of grants for priority social investments, such as education and health." They made no comment on the President' proposal.[4]

Separately, many other G-7 countries expressed opposition to the plan. "It's not something that we agree with," indicated Beverly Warmington, spokeswoman for the British Department for International Development. "The World Bank is actually a bank and there are development agencies to give grants. It's important that the World Bank work alongside them instead of competing with them."[5] Michael Hofmann, director general for Germany's Ministry of Economic Cooperation and Development, was also quoted as saying that he thought an important element was missing from the President's proposal. If it had been accompanied by an announcement that the President would ask Congress to increase the American contribution by a specific amount, he said, "then the whole thing would have had a very different melody." If none of the G-7 countries really want to increase their IDA contributions, he said "such a suggestion can mean only one thing: reducing the business of the bank." The French noted that, while they supported the idea of grants, the U.S. proposal went

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[2](...continued)
Department later released a fact sheet supplying additional points supporting a grant program. It claimed that the President's proposal would make possible a major new increase in funding for education. This would be consistent, it noted, with the President's theme that no child should be left behind, that every child must be educated. "It is often difficult for [the world's poorest countries] to generate the economic returns with which to pay back funds borrowed for education and other development priorities," the Department observed. It makes little sense, either for the borrower countries or the MDBs to be financing projects "with loans that cannot be repaid," it said. More assistance could be provided, with grants, it argued, for health, education, nutrition, water supply and sanitation projects in poor countries benefitting children. In a subtle change, it noted that, under the President's proposal, "*up to* fifty percent" of IDA assistance to the world's poorest countries could be provided in the form of grants rather than loans. [Emphasis added.] U.S. Treasury Department. Fact sheet titled "Increasing Grants and Improving Education in Poor Countries." Dated July 10, 2001 but released after the President's speech.

[3] Communique. Group of 8 (G-8) heads of state and government. Genoa, July 21, 2001. Available from [http://www.G7.utoronto.ca/g7/summit/2001genoa/finalcommunique.html], provided by the G-7 resource center at the University of Toronto..

[4] Communique. Group of 7 (G-7) heads of state and government. Genoa, July 21,2001. Available at [http://www.G7.utoronto.ca/g7/summit/2001genoa/g7statement.html].

[5] Joseph Curl. "Bush asks billions for poor nations; Takes proposals to World Bank." Washington Times. (July 18, 2001), p. A1.

further than they could support. The German government told a meeting of World Bank donors (negotiating terms for a new IDA replenishment) in June 2001 that it could not go beyond 10% grants without breaking a promise to its parliament.[6]

Others have also expressed doubts about the President's plan. Jerome Booth, an emerging markets fund manager, argued, for instance, that the proposal for 50% IDA grants was either a preposterous example of ignorance about IDA finances or a ploy to cut the World Bank down in size. He suggested that the effort to expand the flow of grants through IDA might be an attempt by the Administration to cover the fact that the United States was reducing its overall level of bilateral foreign aid.[7] Others questioned whether the IDA donor countries would be willing to contribute the additional funds necessary to make the new plan feasible.[8] Columnist Milan Vesely claims that the new proposal was "posturing." He noted that Condoleezza Rice, the President's National Security Advisor, had said that the grant plan would have no financial impact on IDA for ten years. He observed, that she had not said when or whether the Administration planned to ask Congress for money to help fund future costs.[9] Nancy Alexander , spokesperson for an NGO critical of globalization, suggested that, when combined with the World Bank's proposed Private Sector Development Strategy, the President's plan for IDA grants poses serious risks to the well-being of poor people by reducing their access to the education, health, and clean water services it presumably wishes to support.[10]

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[6] Sanger, David E. (2001) "Rich nations Offer a Hand, But the Poor Hope for More." New York Times. (July 21, 2001), p. 7. This may be a consequence of the German system of budgeting for IDA contributions. The United States Congress appropriates money for IDA contributions (budget authority), which is available for many years and can be drawn by IDA when needed (outlays) to help fund disbursements for IDA projects. By contrast, according to World Bank sources, the Germans vote money each year for their share of IDA's expected annual disbursements. Considerable care must be taken to match the amount voted with the amount IDA will actually need to draw in the coming year from the German pledge. The German government has less reason to be concerned than does the U.S. Administration that its will refuse to provide the money.

[7] Jerome Booth. "Burdens that can't be passed on." Euromoney, September 2001, pp. 341-43. This article was published in the London-based magazine about the same time that the British government was seeking to persuade other IDA donor countries to resist the Administration's plan. Booth is head of research for Ashmore Investment Management in London, an emerging markets fund manager, and a frequent commentator in the press.

[8] See, for example, remarks to this effect by Mikesell, a professor of economics at the University of Oregon, in his summary of the Commission report.. Raymond Mikesell, "Review Article: the Meltzer Commission Report on International Institutions." *Economic Development and Cultural Change* 49:4 (July 2001), p. 887. Likewise, remarks by C. Fred Bergsten, formerly a former high Treasury official during the Carter Administration. Quoted in Alan Friedman, "'Shadow' Group Seeks to Open G-8 to Poor Nations." *International Herald Tribune*. (July 20, 2001), p. 18.

[9]Milan Vesely, "Will Bush Back Words with Deeds?" *African Business*, London. September 2001, pp. 2021.

[10] Nancy Alexander, Director of the Globalization Challenge Initiative, telephone interview with author, January 24, 2002. See the GCI publication "Growing Dangers of Service

(continued...)

On the other hand, the Administration's proposal for 50% IDA grants has elicited strong support from many groups that are deeply concerned about poverty and strongly in favor of programs to promote equitable and sustainable development. Cardinal Bernard Law, Archbishop of Boston, announced that the U.S. Conference of Catholic Bishops "welcomes President Bush's initiative on poverty alleviation." In particular, he said, the Conference welcomed the proposal that "up to 50% of funds provided by development banks to the poorest countries [be] given in the form of grants rather than loans."[11] John Ruthrauff, senior policy analyst for Oxfam America, stated that "Oxfam America supports the Bush administration's position that half of the IDA funds be grants."[12] Increased grant assistance is particularly important, he said, in order to meet the 2015 development goals, help countries invest in their growth, and avoid increasing their debt. David Beckmann, President of Bread for the World, an aid advocacy group, expressed a somewhat more restrained level of support. "Bread for the World supports President Bush's proposal that some of the next replenishment of IDA should be grants," he stated, "with the understanding that

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[10](...continued)
Apartheid: How the World Bank Group's Private Sector (PSD) Strategy Threatens Infrastructure and Basic Service Provision." *News and Notices for IMF and World Bank Watchers* 2:5 (Winter 2002). Available from [www.challengeglobalization.org].

[11] Cardinal Bernard Law. *Statement on the President's Initiative on Global Poverty Alleviation and Increase in World Bank Grants to the Poorest Countries.* Office of Social Development and World Peace, United States Conference of Catholic Bishops, July 19, 2001. Available at: [http://www.nccbuscc.org/sdwp/international/gloprov.htm]. Cardinal Law is Chairman of the Conference's Committee on International Policy. Catholic Relief Services and Cafod, the overseas development and relief agencies of the Catholic Church in the U.S. and U.K., expressed later a somewhat more muted level of support for the grant plan. The U.S. plan would prevent the accumulation of unsustainable debt by poor countries, said spokesmen for the two organizations, and it would make maximal use of development funds. However, the plan is viable only if donors agree "to offset the cost of reduced repayments to the World Bank resulting from the conversion of loans to grants." The United States could be most persuasive in its advocacy of a grant program, they said, if it would make an "upfront commitment of funds" to allay suspicions that its proposal was merely "posturing in support of the world's poor while continuing to starve them for development resources." They noted that, compared to the size of its economy, the United States provides less foreign aid to poor countries than does 21 other donor countries. See: Loans-to-grants plan needs upfront funds." *Financial Times* [Europe and US editions], January 22, 2002, p. 14. Letter to the editor from the executive officers of both agencies.

[12] John Ruthrauff. *Oxfam America Position on IDA Loans and Grants.* Electronic message to author, January 11, 2002. His statement was approved by Oxfam America's top leadership. It might be noted, though, that Oxfam International, the London-based organization, has expressed more conditional support for the President's plan. Kevin Watkins, a senior policy advisor, was quoted as saying that "We broadly support increased use fo grants in very poor countries, but not the US proposal because of its failure to guarantee funding in the long term." The real problem with the United States, he said, was "that they never put their money where their mouth is." Alan Beattie, "NGOs pressed to back US grant scheme; World Bank move to Replace Loans." *Financial Times* [London Edition], January 17, 2002, p. 9.

the U.S. government will also agree to provide additional funding for the next replenishment."[13]

This report explores the different ways a switch from IDA loans to IDA grants might affect recipient and donor countries and the IDA program itself. The report looks at the role which debt repayments for old loans now play in funding IDA's current loan program and identifies some arguments for and against a switch from loans to grants. It also discusses some earlier proposals for shifting IDA to a grant basis and suggests issues that may be relevant to reaching an agreement among the donor countries on this matter.

Initiation of a program of IDA grants might offer opportunities for increased flows of assistance for education, health, and other social programs. However, as discussed below, the operational effects of a shift from IDA loans to grants may be felt only in the second decade after the change occurred and its full impact would be phased in slowly over a period of up to 40 years. A grant program might allow donors to require that recipients give them more opportunities for monitoring program implementation than might be available for programs financed by loans. However, it might also force the donors to choose between increasing their contribution levels or seeing the IDA program shrink in size. Likewise, the change might offer recipient countries some relief from their debt payment burden over the next forty years (since they would not have to repay the grant.) The efficiency of grant-funded programs might be enhanced but the recipient country might also feel less "ownership" for programs when it has little say in their implementation. Some observers believe that this may have a negative effect on its willingness to continue funding for the program or to keep the original policies in place once the donor withdraws and the program becomes its responsibility.

The Difference Between Loans and Grants

The Terms for IDA Loans

The World Bank provides assistance to its countries through two loan "windows." Legally, they are separate organizations, though in fact they share a common staff, management, policies, and rules. The International Bank for Reconstruction and Development (IBRD) lends mainly to middle-income countries using funds borrowed at commercial rates in world capital markets. Most IBRD borrowers have annual per capita incomes well below the $5,280 ceiling on eligibility. IBRD loans are repayable over a 10 to 20 year period at interest rates slightly higher than those the Bank pays to borrow funds.

The International Development Association (IDA), by contrast, makes loans to the world's poorest countries. Most IDA borrowers have annual per capita incomes well below the $885 ceiling for eligibility. Some small countries – mostly island countries – with marginally higher income levels and low creditworthiness may also

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[13] David Beckmann. Electronic message to author, January 11, 2002.

qualify. IDA loans are funded with money contributed by donor countries. The United States presently contributes about 20% of IDA's new resources. As IDA's uncommitted funds are used up, the donors negotiate new plans every three years to replenish its resources. IDA lends without interest and with principal repayments stretching (after a 10 year grace period) over a 20 to 30 years. The borrower pays a 3/4 of 1% service charge to IDA, which the World Bank uses to cover IDA administrative costs. There is no grace period for the service charge obligation. Except for fast disbursing adjustment loans (which go out over 1 to 3 years), IDA loans are disbursed over a period of 8 to 10 years, as work on their projects is completed.

An Earlier Debate on Loans or Grants

There is no impediment in the IDA Articles of Agreement to grants. The IDA Articles specify that "Financing by the Association shall take the form of loans." However, subsequent language authorizes IDA to provide other types of financing in "special circumstances." Deciding whether such circumstances exist is the responsibility of the Executive Board.[14] Perusal of the IDA Articles and IDA operations will show that a number of activities possible only in "special circumstances" (local cost financing or non-project assistance, for example) are now common (if sometimes implicit) procedures.[15]

As Edward Mason and Robert Asher noted, in their official history of the World Bank, IDA is "simply a fund administered by the World Bank."[16] It was created because most poorer developing countries could not afford to borrow from the IBRD. A U.S. government advisory board, headed by Nelson Rockefeller, and a panel of experts at the United Nations both proposed, in the early 1950s, establishment of a new international development agency or authority to provide assistance on a grant basis for activities that were "desirable on social grounds [but] could not bear the full burden of loan finance." Eventually the proponents abandoned the concept of grants in favor of concessional-rate loans, on the expectation that this would be more acceptable to the prospective donor countries.

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[14] IDA Articles of Agreement, at Article V, Section 3. *Articles of Agreement of the International Development Association*. Entered into force September 24, 1960. Available from the Bank's web site at [http://www.worldbank.org/ida/idaart.htm].

[15] IDA's Articles of Agreement say, at Article V, Section 1(b), that, except in special circumstances, assistance from IDA "shall be for specific projects." In some years, balance of payments support through structural adjustment loans, sectoral adjustment loans, and reconstruction or rehabilitation loans may comprise upwards of a quarter of IDA lending. Article V, Section 3(e) says that, in special cases, IDA "may make foreign exchange available for local expenditures." This is a regular element of many IDA loans and is embodied in the IDA rules allowing potential suppliers in the recipient country a marginal advantage in price when they seek, through international competitive bidding, contracts to supply goods for IDA projects.

[16] Edward Mason and Robert E. Asher, *The World Bank Since Bretton Woods*. The Brookings Institution. Washington, D.C.: 1973. The discussion here is based on chapter twelve, an account of the history and operations of IDA.

IDA originated in a proposal by Senator A.S. Mike Monroney (D-OK) in 1958 to create a new international body that would finance development in poor countries by lending to them excess foreign currencies of other poor countries that were currently owned by aid donor nations. Though economically impractical, the Monroney plan was transformed by the Eisenhower Administration into an agency capable of making hard currency loans to poor countries on easy-repayment terms. Monroney's original concept, loans of excess foreign currencies, though a dead letter, is included in the IDA charter. Some donor countries supported Monroney's idea that IDA loans might be repaid in local currency. As Mason and Asher note, the IDA charter "did not foreclose it; but no use has been made of the provision authorizing such loans."

World Bank management was reportedly more opposed originally to the concept of IDA loans than it was to IDA grants, fearing that a concessional loan window would confuse potential bondholders and drive up the cost of IBRD capital. Officially, IDA provides aid in the form of "credits" in order to distinguish it from IBRD "loans." During negotiations on the IDA Articles of Agreement, many prospective donor countries spoke in favor of the concept that IDA should have the authority to make grants. Mason and Asher report that the United Kingdom, France, Canada and the Netherlands were leading advocates of this view, while the United States was in staunch opposition. The IDA charter specifies that all the assistance provided by IDA from original subscriptions must be used for loans, but it holds open the possibility that resources from future replenishments may be used for grants if specifically authorized by the donor countries at that time.[17]

A Decision to Make Grants

As noted above, an IDA grant program may be created only with the consent of the donor countries as expressed in the new replenishment agreement. The Bank's Board of Executive Directors has the authority to determine when "special circumstances" exist but it has no independent authority to create a formal grant program.[18] A two-thirds vote of the donor countries is needed to approve a new replenishment for IDA. The Administration will need broad support from other countries to bring about the establishment of an IDA grant program. In recent decades, the United States has provided about 20% of IDA's new resources but, for historical reasons, it has a 14.8% voting share. Altogether, the principal donor countries have a 61.3% voting share in IDA. As a practical matter, it is extremely unlikely that developing countries would oppose a new replenishment for IDA. As noted before, though, most other donor countries are – at best – lukewarm in their support for a major IDA grant program. The poor countries would likely also look askance on the suggestion if they believe it would reduce the flow of aid they receive from the Bank.[19]

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[17] IDA Articles of Agreement, at Article V, Section 2.

[18] The Articles specify that the Executive Board shall be responsible for IDA's general operations. IDA Articles of Agreement, at Article VI, Section 5 of the IDA.

[19] See, for example, comments to this effect in Alan Beattie, "Give and Take: European (continued...)

At one time, IDA replenishment agreements could not go forward without the consent of the United States (and therefore the consent of Congress). In recent decades, however, the U.S. contribution share had declined to the point where it no longer has a de facto veto over IDA replenishment plans. The United States also has limited leverage with other donors on these matters. In 1997, other IDA donor countries indicated that – if the United States did not bring its payment arrears up to date – they might create a new international agency to replace IDA. The United States would not be invited to join. Many in the United States believed that this would have serious negative implications for U.S. foreign policy. Congress appropriated $1.035 billion in fiscal 1998 to fully clear the IDA arrears. Many observers doubt that the United States will be able to persuade other donor countries to adopt an IDA replenishment plan whose provisions they do not support.

Comparing the Cost of Loans and Grants

Because of the grace period, IDA receives no reflows from its loans for 10 years. In that respect, IDA loans are the same as grants. Beginning in the 11th year and continuing for the life of the loan, however, IDA receives a stream of repayments of principal, roughly (for a 30 year loan) 3.3% of the amount lent initially.[20] Those repayments can be (and are) used to fund new IDA loans. If the IDA donor countries wanted to keep the IDA loan program at a constant level in nominal terms – $6 billion a year, for example – they could reduce their contributions annually at the end of the 10 year grace period by an amount equal to the new repayments being received. Ultimately, IDA would be able to provide a constant nominal level of assistance to borrower countries without any new contributions by donors. By contrast, if the donors want an IDA grant program to stay at a constant nominal level, they would have to contribute the same amount each year for as long as the program exists.

One might also compare the difference in the cost to the donors if they decided to keep the IDA program at a constant $6 billion annually for 20 years and to close it thereafter. If IDA were a grant program, the donors would need to contribute $6 billion annually (a total of $120 billion) during those two decades. By contrast, if IDA were a loan program, they would need to contribute $105 billion to support the same size program, since reflows would pick up some of the cost during the second decade. The donors could then choose what to do with the repayments IDA would continue receiving thereafter. If they chose to have the funds returned to them (rather than assigning them for another purpose), the donors would receive $105 billion in reflows during the next 30 years.

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[19](...continued)
countries are worried that US proposals to replace half of the World Bank's loans to some developing countries with grants could undermine the organization." *Financial Times* , London. (July 20, 2001), p. 20.

[20] This assumes a loan with a ten year grace period and thirty years for repayment of principal. The annual repayment figure would be higher for IDA loans with shorter repayment terms. However, these comprise a minority of all IDA assistance.

The Benefit to Recipient Countries

The net-transfer of resources from an IDA grant program to the recipient countries would be 100%, since no repayments are expected. By contrast, on a face value basis, the net transfer of resources from an IDA loan is zero, since all the money lent must be repaid.

This calculation overlooks, however, the time value of money. Because the repayment terms for IDA loans are very easy, there is a substantial grant element to IDA loans. The net present value of the repayments from an IDA loan must be discounted substantially because of their negligible interest cost and their long payment terms. World Bank accountants estimate that the grant element of an IDA loan in 2001 was 44% or 47% or 67%, depending whether the comparison is made to G-7 official borrowing, private borrowing, or the standard 10% discount rate used by the Development Assistance Committee (DAC) of the OECD.

A grant program is a one-time transfer of money. By contrast, the IDA loan program is a revolving fund. Thus, it can recycle the grant element of its loans indefinitely as the repayments from old loans are used to fund new loans. (The real value of IDA's future loans will likely be lower in the future, because of exchange rate fluctuations and inflation.) Each subsequent IDA loan would have a positive developmental impact, so long as the projects are effectively designed and implemented. For grants, the money that would have been used for loan repayments would stay in the country. Its developmental impact will depend on the government and the economy's capacity for making effective use of those resources.

IDA's Repayment Record

Some supporters of the President's proposal argue that IDA should shift its assistance program to grants, as they believe there is little likelihood anyway that IDA's existing loans will be repaid.[21] Mary Ellen Countryman, White House assistant press secretary for foreign affairs, told the press that President's plan is simply plain speaking. "Let's call it what it is. A lot of the loans aren't getting paid back anyway."[22]

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[21] See, for example, remarks to this effect in *Newsday*, "Poor Nations Need More Grants, but Who Will Pay?" (Editorial). Long Island, N.Y. (July 19, 2001), p. A36. The *Chicago Sun-Times* opined, favoring Bush's grant plan, that there is "little difference between loans that aren't paid back and outright grants anyway." *Chicago Sun-Times*. "Call It What It IS." Editorial. (July 26, 2001), p.35. Felix Rohatyn also seems to believe that IDA loans are likely to be forgiven anyway. He says that grants are more straightforward and "can be tied to a number of conditions to make them more effective for the recipient country." Felix Rohatyn, "Back to Bretton Woods: the anti-globalization protesters have a point, argues Felix Rohatyn, It's time to reform the IMF and World Bank." *Financial Times*, London edition. (August 20, 2001), p. 17.

[22] Quoted in Joseph Curl. "World Bank contributors oppose Bush plan for grants." *Washington Times*. (July 19, 2001), p. A14.

Others point out, however, that by and large, IDA has a good repayment record. Seven countries are currently overdue in their loan payments. Together, Afghanistan, Congo/Zaire, Congo Republic, Liberia, Myanmar, Somalia, and Sudan are $469 million in arrears. Much of this balance has been accruing since the early 1990s (1988 for Liberia).[23] The total amount lent to these countries was $3.8 billion, most of which is not yet due. At the end of its fiscal year 2000, IDA had $85.8 billion in disbursed loans outstanding to all borrowers.

Those seven countries currently have no effective government or their government is at serious odds with most of the rest of the world. The World Bank expects that – as has been the case before – they will settle their overdue obligations once their current problems have ended or a new government takes the helm. The World Bank stops making disbursements on its existing loans and it ceases all consideration of possible new loans when a country becomes 6 months or more in arrears. Many IDA borrower countries have no real sources of international credit other than the World Bank.

In their argument that IDA loans are not repaid, the advocates of grants may be referring more to the HIPC program. Heavily indebted poor countries (HIPCs) may qualify to have much of their debt owed to bilateral creditors and multilateral banks forgiven. Qualifying for HIPC assistance remains – though it has been expedited for 20 countries in the past year – a rigorous process. Among other things, countries need to be current on their loan payments and adopt major programs of economic policy reform. HIPC debt is being forgiven, not because the borrowers are not paying, but because the donors are concerned about the human and development costs that will ensue as the debtors continue to service their debts. Except for debt expunged through HIPC, the World Bank does not forgive loans.

Reflows as a Share of IDA Usable Funds

The amount which IDA is receiving annually in principal repayments for prior loans has grown substantially in recent years. Ten years ago, during the World Bank's fiscal 1991, IDA reflows totaled $274 million. In 2000, by contrast, the flow of principal repayments totaled $920 million. By 2005, the amount will likely rise to $1.95 billion. As will be discussed below, a substantial share of those future reflows has been earmarked to fund new projects that have already been approved.

The inflow of these resources has enabled IDA to shift a greater part of the cost of funding its future loans onto reflows, reducing the amounts required from donor countries. Donors make their contributions in the form of non-interest bearing non-negotiable promissory notes. The balances on those notes are encashed as IDA needs money to fund the disbursements on its existing loans. Overall, in 2000, IDA had a cash flow of $5.6 billion supporting its current disbursement program. Of this, $920 million was from reflows and $4.68 billion was drawn from the donor's outstanding promissory notes. On this basis, in terms of its total operations, IDA loan repayments currently account for 20% of the resources available to fund IDA lending operations.

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[23] World Bank. *Annual Report, 2000.* Washington, D.C., 2000.. Volume 2, p. 88.

The figure is different, however, for projects funded from the IDA 12 replenishment plan. In that replenishment, contributions from donor countries comprise about 60% of the funds available to fund IDA loan commitments approved during the period 2000 to 2002. Loan repayments account for the remaining 40%. The pool of IDA reflows earmarked to help fund loans funded with IDA 12 resources does not include only the repayments IDA expects to receive during that three year period. It also includes a major share of the loan repayments that IDA will receive during the following decade during which it will be making disbursements to implement IDA 12 loans.[24]

Reportedly, the IDA donor countries plan to use this same procedure in future replenishments to help reduce the budgetary cost to them from the IDA program. At some point, though, they will likely find that most of the loan repayments scheduled for receipt during a future replenishment period will have already been earmarked to fund loan commitments from earlier replenishments. If successive three-year IDA loan plans are funded in part with reflows that are scheduled for receipts during the next eight-to-ten years, the stream of uncommitted reflows will soon be exhausted. Presumably, at some point, the donors will need to decide whether the existing size of IDA's loan program should be maintained through increased payments or whether it program should shrink to a level that can be supported solely by the donors' contributions.

President Bush did not propose that IDA's existing loan portfolio should be converted retroactively into grants. The World Bank is writing off (through the HIPC program) some IDA debt owed by poor countries. However, no thought has been given to writing off all the IDA debt owed by all countries. Reflows would continue to be available from earlier IDA loans. The current talk about grants concerns the nature of IDA's *future* aid program.

Earlier Proposals for IDA Grants

General Support for the Concept

The concept of IDA grants had been under discussion for some time. There seems to be a broad base of international support for the basic concept that some IDA assistance should be provided on grant terms. Until President Bush made his proposal, however, few proposals seemed to contemplate that a large share of IDA resources would be allocated on such terms. The IDA eleventh replenishment agreement (IDA 11) said in 1996 that the World Bank could use some of the resources from the replenishment (in selected cases, in exceptional circumstances, and

[24] In effect, the current arrangement resembles a plan proposed earlier by the author. Both assume that future reflows can be pledged for use today either because they will not be needed in the distant future (because of developmental success) or because they will be in replaced by increased donor contributions. If these assumptions are not well founded, then the advisability of both plans may be subject to doubt. See Jonathan E. Sanford, "Feasibility of a World Bank Interest Subsidy Account to Supplement the Existing IDA Program." *World Development* 16:7 (1988), p. 787.

on a limited scale) for grants. The IDA 12 agreement (1999) said that the World Bank could make some IDA grants in connection with the HIPC program. Until late 2001, at least, most of the donor countries participating in talks about a new replenishment of IDA resources (IDA 13) had reportedly been willing to consider a grant program involving perhaps 10% to 20% of IDA funds. Meanwhile, Bank President James Wolfensohn reportedly favored the idea of an IDA grant program totaling up to $1 billion annually.[25]

U.S. Secretary of the Treasury Lawrence Summers proposed, at the World Bank-IMF annual meeting in September 2000, that IDA should provide more grant assistance to its recipient countries. Specifically, he said, precautions should be taken to avoid loading up heavily indebted poor countries (HIPCs) with new debt once the HIPC program had reduced their foreign debt to sustainable levels. "Further restraint on concessional lending may also be warranted," he said, "including though greater recourse to grant financing." IDA should also put more emphasis, he said, on education, health, and other social programs. Summers did not put a number on his recommendation. Treasury officials suggest, however, that, in private discussions, Summers was advocating a 20% grant level at the time.[26]

Discussion of an IDA grant program has taken place in context where, to an increasing degree, most foreign assistance is given to low-income countries on a grant basis. On the average, between 1971 and 1973, 55% of the official development assistance (ODA) the rich countries provided to poor countries on a bilateral basis took the form of grants.[27] Between 1988 and 1989, grants comprised on average 78% of their bilateral ODA. By 1999, almost 90% of the bilateral ODA from the richer countries was grant aid.[28] For many IDA donor countries, all of their bilateral foreign assistance is provided on grant terms.

Congress has spoken favorably on the question of IDA grants. In 2000, Congress included language in the fiscal 2001 foreign operations appropriations act – H.R. 5526, later incorporated by reference into H.R. 4811 (P.L. 106-429) – urging the World Bank to make IDA grants a component of its plan to assist heavily indebted poor countries (HIPCs). Specifically, it directed the Secretary of the Treasury to

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[25] John Donnelly "Change at World Bank Requires Donor Support; Some May Balk at Higher Costs." *Boston Globe* (July 18, 2001), p. A24. See also Phillips, *op. cit.*

[26] Interview with William E. Schuerch, Deputy Assistant Secretary of the Treasury for International Development, Debt, and Environment Policy, January 10, 2002. Schuerch served in the same position during the Clinton Administration.

[27] Rutherford Poats, Chairman. *Development Co-operation: Efforts and Policies of the Members of the Development Assistance Committee, 1982*. [Annual Report.]. Organization for Economic Cooperation and Development: Paris, 1982 Table II.A.14, p. 219. The rich countries included in these figures include the 22 members of the Development Assistance Committee (DAC) of the Organization for Economic Cooperation and Development (OECD).

[28] Organization for Economic Cooperation and Development. Development Cooperation. Table [from *Development Cooperation, 2000*, the annual report of the OECD Development Assistance Committee (DAC).] Available from the OECD web site at [http://www.oecd.org/oecd/pages/home/displaygeneral/0,3380,EN-home-notheme-2-no-no-no-0,FF.html].

seek the adoption of a new policy at the World Bank specifying that all new assistance should be on grant terms for countries that have reached the completion point in the HIPC process.

In 2001, the U.S. Congress included language in H.R. 2506, the fiscal 2002 foreign operations appropriations act (P.L. 107-115) reiterating this concern. It directs the Treasury Secretary to give "high priority" and to "vigorously advocate" the adoption of policies (during the current talks about the terms for a new replenishment of IDA resources) which would enable IDA to provide grant assistance (rather than loans) for countries eligible for HIPC debt relief. The House Appropriations Committee said, in the report (H. Rept. 107-142) accompanying its legislation, that IDA should provide all-grant assistance to each HIPC beneficiary country for a three year period following its HIPC decision point. The Committee also said that it agreed with the recommendations of the Meltzer Commission (see below) "With respect to its support for multilateral debt forgiveness under certain conditions and conversion of IDA into an agency making poverty alleviation grants." It is not clear from the report language whether the Committee believed that all IDA assistance to all countries should be provided on grant terms or whether such grant assistance should be limited solely to HIPC countries.

Meltzer Commission Proposals

The Commission Report. The President's proposal was also proceeded by other proposals seeming major reductions (and sometimes elimination) in the international financial institutions (IFIs). Most prominent among these was the March 2000 report of the International Financial Institution Advisory Commission, chaired by Allan H. Meltzer.[29] Meltzer is an economics professor at Carnegie Mellon University. To some observers, many of the arguments voiced by the President – the points about increased effectiveness and ex-post evaluation, for example – resemble those made earlier by that panel. U.S. Treasury Department officials maintain that the Administration's proposal for 50% IDA grants was not derived from the Meltzer Commission report. Rather, they argue, it is based on sound development principles. Linking them together, they say, is guilt by association.

The IFI Advisory Commission was created in 1998, as part of legislation enacted that year authorizing U.S. participation in the most recent quota increase of the International Monetary Fund. The eleven members of the panel were appointed by the House and Senate leadership (six by the Republican majority and five by the Democratic minority.) The Commission issued its report on the strength of an 8 to 3 vote, although one member signed both the majority and minority reports. Many of the Commission's recommendations and findings were controversial. Among other things, it proposed that the World Bank should cease making loans (except in

[29] Meltzer, Alan H., Chairman. (2002) *Report of the International Financial Institution Advisory Commission*. March 2000. NP.

certain circumstances[30]), focusing instead on special purpose grants. Two kinds of grant programs were mentioned.[31]

The Commission recommended that the Bank replace its loan program with a program of grants aimed at alleviating poverty and promoting structural reform.[32] It would not fund the traditional types of development projects. Healthcare, primary education, and physical infrastructure were mentioned as possible areas of emphasis. Focusing on the poorest countries, those with per capita annual income levels below $2,500, it would be funded by contributions from the industrialized countries. The new program would be costly, the Commission said, and "[t]he amount of money requested from legislatures to fund explicit grants should rise." In addition, it said that "[t]he United States should significantly increase its support of effective programs to reduce poverty. The six dollars per capita currently spent is too much for ineffective programs but too little for effective programs."[33]

The Commission also proposed that another grant program should be created, terminating and replacing the existing World Bank.[34] Under this plan, the Bank would transfer all or most of its callable capital assets to the regional MDBs, to help them broaden their responsibilities. The World Bank's paid-in capital and retained earnings would be transferred, however, to a special trust fund. The income generated by that trust fund would underwrite a grant program addressing global public goods. These include environment, communicable disease, inter-country infrastructure systems, development of agricultural technology, and the creation of improved managerial and regulatory practices. The Commission did not say how large it thought the program should be. In 2000, IBRD paid-in capital totaled $11.4 billion and retained earnings totaled $19 billion. If this were invested in U.S. Government bonds at 5%, the yield would be in the range of $1.5 billion annually.

In both cases, in what may be the Commission's most innovative concept, the grants would be channeled through private suppliers who would be reimbursed for their costs only if independent auditors found that they had met specific quantitative performance goals which had been agreed to in advance. If the goals were not achieved, the service provider would not be paid. In both plans, reimbursement would be on a sliding scale, declining as a share of total costs as the income level and credit rating of the recipient country increased. Programs in the poorest countries would get a 90% subsidy; those in the most prosperous would get a 10% subsidy. The

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[28] The Commission said that, until the African Development Bank was ready to assume full responsibility for development lending in its region, the World Bank should continue making IDA loans to African countries. It also said that IDA should continue making loans to the low-income countries in the Middle East which currently qualify for IDA assistance. There is no development bank for that region. Commission report, p. 94.

[31] The Commission plan was also described later, with some elaboration, by Adam Lerrick, who served as Senior Advisor th Chairman Meltzer. See Adam Lerrick, "A better way to lend a hand." *The International Economy* (Washington), November/December 2000, p. 14.

[32] Commission report, pp. 89-93.

[33] Commission report, pages 91 and 96.

[34] Commission report, pp. 93-95.

local government would have no role in the actual implementation of the programs, but it would be expected to pick up the cost not covered by these grants.

The two plans outlined by the Commission were intended to hold program managers to a higher standard of accountability and performance than is the case today. This might increase the efficiency and cost-effectiveness of programs. The donor countries might also be able to require that the implementing agencies allow them to monitor programs funded by grants more closely than might be possible for programs implemented by governments and funded by loans.

Critics contend that there are possibly serious drawbacks to these plans. For example, they say, it is doubtful that many private organizations would be willing to implement IDA grant programs if they have to provide the money to carry out the programs themselves, with no real guarantee that they would be reimbursed later. Few charitable organizations have such deep pockets. The cost of borrowing money to implement these programs (based solely on the prospect of a contingent guarantee) may be prohibitive. Too many things can go wrong – the original goals of the project may prove unattainable, close monitoring by donors may complicate the process, or factors beyond the implementing agency's control may hinder success. For-profit contractors might be willing to take the risk, critics note, but the cost (likely substantial) of that risk would need to be built into the price they would charge the international agency.

In any case, assistance programs channeled through private organizations will still need the permission and cooperation of governments. Private organizations (particularly those who are paid only if they succeed) may be vulnerable to demands by corrupt government officials or requirements that funds be spent for sub-optimal purposes. In addition, perhaps for legitimate reasons, governments may be reluctant to pay their share of the costs if they have no control over program operations.

The plan for a grant program addressing global public goods might be a valuable undertaking, particularly if it could be done at no cost to contributors. However, the use of World Bank resources in this manner would have major opportunity costs in terms of other alternatives not pursued. The World Bank and the regional banks already address many of these issues (particularly health) in their current loan programs. International agencies, such as the Global Environmental Fund, World Food Program, and World Health Program address many types of global problems.

The amounts available to fund a grant program for global public goods would also be much smaller than that envisioned by the Commission's plan, critics argue. The regional banks would be unable to make much use of callable capital transferred to them by the World Bank unless it was accompanied by the associated paid-in capital. Callable capital alone would not be a sufficient basis for expanding the regional banks' borrowing programs. Without matching paid in capital and additional reserves, such borrowing would increase their exposure. Too much lending funded in this manner could lead to reductions in their bond ratings. Transfers of paid-in capital would be needed before the regional banks could expand their operations and replace the World Bank, as the Commission recommended..

The amount available to fund the trust fund from IBRD retained earnings may also be less than expected. The Bank's Articles of Agreement say that, if the IBRD terminates operations, any funds remaining after all the Bank's debts have been paid shall be returned to the member countries. This presumably includes the accrued net income of the Bank as well as the paid-in capital. There is no assurance – particularly if major countries disagree with the plan – that many assets would remain after the breakup to fund a global trust fund.[35]

Subsequent Proposals. Some observers have expressed concern that the Bush Administration ultimately seeks the adoption of a plan for IDA somewhat along the lines recommended by the Meltzer Commission. If so, they wonder what effect this might have on future U.S. policy towards the World Bank and IDA.

Their concern was heightened by the appearance, in the week following the President's speech, of a proposal to shut down the World Bank and to use its assets to finance grants. On July 26, 2001, the *Wall Street Journal* published an oped article by Meltzer and Adam Lerrick, his principal advisor on the Commission.[36] It argued that IDA's loan program should be replaced by a self-financing grant system. Meltzer and Lerrick note that IDA currently has $108 billion in rich country contributions on its balance sheets, partly in loans and partly in cash.[37] They argue that IDA could invest these cash balances at what they claim is a conservative rate of 8%, producing a perpetual income stream which might be used to fund $8.6 billion in new grants every year without any further need for donor contributions. It is unclear whether they believe the full assets of IDA should be invested in this manner now or if the cash should be invested now and the reflows should be invested later as they are received Both approaches are implied in their article. They say the World Bank's resistance to their proposal is motivated by intransigence, institution arrogance, and its "lack of basic arithmetical skills."

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[35] World Bank Articles of Agreement, at Article VI, Section 5. Article V, Section 2 says that the Board of Governors has the authority to determine the distribution of the Bank's annual net income. Section 14 says that the Governors shall determine annually what share of the net income should be placed in reserves and what share should be distributed to members. Although the Governors have chosen annually to allocate all net income to reserves, the money nonetheless the collective property of the member country governments and could be distributed to them upon vote of the Governors. *Articles of Agreement of the International Bank for Reconstruction and Development.* Entered into force December 27, 1945. Available from the World Bank's web site at [http://www.worldbank.org/html/extdr/backgrd/ibrd/arttoc.htm].

[36] Adam Lerrick and Alan H. Meltzer, "The World Bank is Wrong to Oppose Grants." *Wall Street Journal*. (July 26, 2001), p. A14. See also the reply by the Bank's Senior Vice President and Chief Financial Officer, Gary L. Perlin. Letter to the Editor. *Wall Street Journal* (August 6, 2001), p. 13.

[37] In 2000, the face value of IDA's assets was $101 billion, after allowance for $7 billion in debt written off via the HIPC program. Technically, the $7 billion has not been booked against total assets and is being carried on IDA's books as a negative balance in reserves. See World Bank *IDA Special Purpose Financial Statements*, June 30, 2001.

The concept outlined in the Meltzer-Lerrick plan may be feasible. However, critics argue, its potential benefits should be compared with those available through continuation of the existing program, and that the amount of assistance which might be available through their plan is likely to be smaller than they presume. IDA's assets could be invested, as Meltzer and Lerrick propose, but the fair market value of IDA's portfolio is much smaller than they suggest. IDA does not have the contractual authority to recall its loans or to demand early payment of the balance due. If it wants to turn its loan portfolio into cash, those assets will have to be sold to another party.

According to this interpretation, if IDA were able to sell its assets and the purchasers paid what the Bank considers the "fair market price," it might be able to get $56 billion which it could invest.[38] Ten year U.S. Treasury notes currently yield 5%. Investing the full $56 billion on a no-load, no-cost basis, IDA might be able to realize something like $2.8 billion annually to fund a future grant program. On a grant-equivalency basis, this is less than half the size of the current IDA program. It is also about one-third the amount that Lerrick and Meltzer believe might be available from implementation of their plan.

Two other considerations might be assessed. First, potential purchasers may be unwilling to pay the amount the Bank considers to be the "fair market" value of IDA assets. They may worry that the former IDA borrowers will be less inclined to pay the new private owners of their notes, since the new owners are unlikely to make them future concessional loans. In that case, the amount generated by the proposed investment scheme would be less than that estimated above. Second, IDA's assets likely are worth more if IDA remains a functioning organization than they would be if it were liquidated. In the former case, the debtor countries are more likely to pay and IDA would not need to discount the value of its assets as it uses loan repayments to fund future loans.

Professor Meltzer has spoken out strongly in favor of the President's proposal, though he has given it his own interpretation. The plan will work, he says, and claims by Bank spokesmen that donations would have to increase dramatically are incorrect. "Despite what they say, the grant proposals would be more efficient; that is, they would be able to give more aid with the existing resources," he wrote. For instance, he observed, the World Bank could give half the amount it would normally lend and

[38] The face value of IDA's disbursed loan portfolio is about $86.6 billion. According to World Bank accountants, its "fair market value" in June 2001 was between $46 billion and $49 billion. The face value of the portfolio must be discounted, not only for net present value, but also for credit risk, seasoning, multilateral and sovereign risk preferences and other factors. The promissory notes from donors and the IDA's liquidity pool (its remaining assets) are fully committed to finance existing loans. If someone buys those loans, the price would presumably be reduced to offset these undisbursed but committed funds, as IDA has already agreed to use them to cover the IDA share of projects currently being implemented. A new owner would presumably acquire this obligation as well as the funds. Thus, the value of IDA's "cash" resources must be discounted in a manner similar to that used for outstanding IDA loans. Including the discounted value of these funds would bring the total up to about $56 billion. See World Bank *IDA Special Purpose Financial Statements*, June 30, 2001, p. 24.

countries could borrow the rest commercially "because they would have the Bank's guarantee."[39] It might be noted that, under this interpretation of the President's plan, countries would pay commercial interest rates for half the money they used to fund a project and IDA grants would fund the rest. On average, the combined rate they would pay would be higher than the World Bank and other MDBs now charge for their ordinary near-market rate loans. Presumably, if the World Bank guarantees the repayment of the commercial loans, the recipient countries would have to pay the Bank its usual fee for such service.

Brett Schaefer also stated, in a report prepared for the Heritage Foundation, that "Clearly the time has come for the World Bank to implement performance-based grants." The Administration should make sure, he said, that new funding for the next IDA replenishment would be used for the grant proposal. He also proposed that the Administration seek agreement among other IDA member countries for an arrangement to use existing IDA resources for the grant proposal as they are repaid. He said that Congress should prohibit any future U.S. participation in IDA replenishment plans until IDA implements the grant proposal. He said that $873 million would be available to fund grants if the full resources of the next IDA replenishment (presumably $11 billion) were invested at 8% for that purpose.[40]

Schaefer's proposal would also go well beyond that proposed by President Bush. He would have the existing IDA program (which lends $6 billion a year) replaced by a grant program about 15% its size (less if – as suggested by critics – a more realistic interest rate for investments were used and allowance is made for reflows already committed to support previously approved IDA loans.).

The Administration's Argument for Grants

U.S. Treasury Department officials deny, as noted earlier, that the current U.S. proposal for 50% IDA grants is based in any way on the Meltzer Commission report. They note that Treasury Secretary Paul O'Neill was strongly critical of the Meltzer Commission's findings in his required report to Congress, discussing steps taken to implement the recommendations of the Meltzer Commission.[41] Virtually every argument and finding was refuted, they argued, in detail.

The developmental effects of IDA need to be enhanced, Treasury argues. The other donor countries say they want to do more, says the principal U.S. negotiator, but – except for the United States – none seem willing to increase their contributions. A grant program would intensify IDA's impact at a relatively modest indirect cost to donors. The World Bank found that a 40% IDA grant program would reduce repayments by approximately $570 million a year in the decade following the end of the 10 year grace period (see below), he mentioned. Considering the overall cost of

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[39] See Phillips, *op. cit.*

[40] Brett Schaefer, "Real Help for Poor Nations: President Bush's World Bank Grant Proposal." The Heritage Foundation. *Backgrounder*. No. 1466. (August 20, 2001).

[41] Interview with William E. Schuerch, January 10, 2002.

funding IDA, he argued, this would be a rather modest price to pay. He noted that, with the decline in commercial interest rates in recent years, the grant-equivalency of IDA loans has fallen substantially (to about 65%, he calculated) from much higher levels in the 1980s.

In many instances, he argued, grants are a more appropriate way of providing assistance for long-term needs. Investments in social sector programs are crucial, but their growth effects are not realized until many years in the future. Consequently, they generate little income to help countries repay the loans which financed them. Increasingly, he maintained, most foreign aid is provided on grant terms. Some 99% of the official development assistance that DAC countries provide to very low income developing countries now takes the form of grants. Many of the countries most resistant to IDA grants give most or all of their bilateral aid to poor countries as grants. He noted that, while the United Kingdom was strongly opposing the concept of IDA grants, the U.K. Chancellor of the Exchequer gave a speech in Ottawa supporting the establishment of a new multi-billion dollar trust fund to address (through grants) millennium development goals. He also recollected that a Scandinavian country now opposing IDA grants had advocated 100% grants a decade earlier.

There is no intrinsic reason to believe, he argued, that repayments for IDA loans needed to be recycled through the World Bank for them to be used effectively for development purposes. Arguably, he maintained, if the policies and institutions of recipient countries are sufficient, their governments and private sector should be better able to make effective use of the income and benefits generated by IDA projects to promote their own development. In any case, he asserted, the argument that IDA has an excellent repayment record is misleading. In the past decade, the G-7 countries and others have agreed to forgive most or all of the repayments due from earlier bilateral aid loans to heavily-indebted poor countries. IDA has become, in effect, a preferred creditor. The donor countries have been willing to forego repayment of their old bilateral loans in order to ensure that debts to IDA can be repaid. Since IDA has no bondholders (like the IBRD) who must be repaid, and since the countries forgiving bilateral debt are the same ones responsible for most IDA contributions, he argued, IDA's high repayment record is not an accurate reflection of its financial situation.

There is no relationship, the Treasury Department asserts, between the President's proposal for 50% grants and the World Bank's private sector development strategy. "Treasury is taking its policy leadership from the President's speech at the World Bank on grants," stated the official principally responsible for implementing U.S. policy.[42] "That speech has a list of purposes for which grants might be used – education, health, water and sanitation, and a couple other things. That list does not include private sector activities or private provisioning of services." He indicated that the IDA deputies had agreed, during their negotiating sessions, that nobody was against the concept of private provisioning of services *per se*, though several countries had reservations. Everybody also agreed, he said, that governments

[42] Interview with William E. Schuerch, February 6, 2002.

are responsible for these activities and any private programs would need to be monitored by them.

British and Other Views

Clare Short, the U.K. minister for international development, has taken the lead in mobilizing opposition to the U.S. proposal for expanded IDA grants. The Scandinavians and other European countries have also expressed strong reservations concerning the U.S. plan. Reportedly, they believe that poor countries will be less likely to squander World Bank aid if they know they will have to repay it some day. Some also reportedly suspect that Treasury Secretary O'Neill seeks to undermine IDA's financial base through advocacy of the 50% grant scheme.[43] Development Minister Short has reportedly stated that "IDA is very valuable and we are looking to increase our contribution substantially. But if it is compromised [by a large grant program], we would look to give more bilaterally instead." France, Germany and Japan have indicated, by contrast, that with the declining international value of the euro and yen, they cannot afford to contribute the same share to the new IDA replenishment as they gave to the last.[44]

The British government issued a statement in February 2002 further explaining its views on the issue of IDA grants or loans.[45] It made four points. First, it asserted, the current system makes more effective use of the limited aid funds which are available to help poor countries. Reflows from old loans are a major element of the procedure for financing IDA. With grants, there would be a gap – billions of dollars a year in the third and forth decades – that would have to be filled by major increases in donor contributions. "It seems reasonable to assume that there will be an ongoing need for IDA finance," it stated. "On this basis, we should be taking a long term-view."

IDA should remain a loan program, the statement argued, because this enhances ownership and promotes effective cooperation among donor agencies. The World Bank and the other international development agencies should work in partnership, not in competition. "A clear and selective strategy for IDA and effective collaboration amongst agencies are two of the great reforms we have all worked on in the past few years.[46]

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[43] Paul Blustein, "U.S.-Europe Clash Stalls World Bank Aid Plan; Bush Seeks Grants, Not Loans." *The Washington Post*, January 30, 2002, p. E1.

[44] Alan Beattie, "Deadlock in dispute over money for poor nations; World Bank Contributions." *Financial Times* [London edition], January 15, 2002, p. 10.

[45] [U.K. Department of International Development.]"Loans or Grants: IDA's Concessional Lending Role." ND. Provided to the author by the Office of the U.K. Executive Director to the World Bank and IMF, February 8, 2002.

[46] The British also emphasized this point in an earlier statement on IDA. "Substantial grant funds are available from other development agencies–particularly the UN, bilateral donors and the European Commission," it observed. "It is important that the World Bank should work in (continued...)

Third, said the statement from Ms. Short's department, "We do not accept that IDA's current terms are always inappropriate for interventions in health or education, or that cheaper finance would encourage countries to invest in these areas more." Donor countries should not try to dictate to developing countries what their priorities should be, it said. Rather, the donors should encourage countries to establish their spending priorities through a system of broad national consultation, such as is embodied in the Bank's Poverty Reduction Strategy process. Grants should be reserved for special situations – such as post-conflict recovery or regional programs to combat infectious disease – where IDA's normal loan program might be inappropriate.

Finally, the British disputed the argument that IDA countries could not afford to repay IDA loans. The statement noted that IDA's repayment record has been very good. IDA loans "provide a bridge," it said, "between grants and non-concessional borrowing." By demonstrating that they can repay concessional loans, countries help lay the groundwork for their future entry into the regular international financial system. Even the idea that IDA grants should be targeted to HIPC countries (after they have relieved debt relief) is a mistake, the statement argued. "If poor countries exiting from HIPC cannot even service new debt on IDA terms," it said, "then HIPC will have failed." Rather than planning for failure, it maintained, the international community should expect that HIPC graduates will grow, develop, and take their place in the world economy.

Negotiating IDA's Terms

During 2001, representatives from the IDA donor countries met on several occasions to discuss terms for the next IDA replenishment. The World Bank has reportedly suggested that an appropriate level for the IDA 13 replenishment would be SDR 18.1 billion (about $23 billion), including SDR 500 million for HIPC debt forgiveness. Of this amount, some $12.5 billion would be solicited as new contributions from donor countries. The remainder would be provided from IDA reflows and other sources.

At the first negotiating session in February, the World Bank presented an analysis of the potential effects a grant program might have on IDA finances. The Bank reported that a 20% grant program would drain IDA's resources by some $400 million during the first ten years and $4.3 billion during the next decade. On the other hand, the Bank reported, IDA's financial base could be strengthened if a 20% grant program were matched by a program hardening the repayment terms for 20% of IDA's remaining loans. The Bank suggested that higher interest charges and shorter

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[46](...continued)
partnership with these other agencies not in competition with them, with each institution respecting each other's comparative advantages." See: Office of the U.K. Executive Director to the World Bank and IMF. Statement titled "Loans or Grants: IDA's Concessional Lending Role." ND (Provided to author on August 6, 2001.)

repayment periods might be appropriate anyway for countries approaching graduation or for countries with per capita income levels near the top of the eligible range.[47]

President Bush's proposal for a 50% grant program changed the context for the negotiations. Instead of 20% being the leading edge, it now became a level far lower than that preferred by IDA's largest donor country. The U.S. representatives reportedly told the other donor countries in October that a failure to move towards grants could jeopardize the size of the U.S. contribution. The 50% proposal widened the differences among the donor countries. As noted earlier, the British strongly opposed the U.S. proposal while some other countries were reportedly willing to go as far as the 20% figure presented in the February World Bank report. In November, Ms. Short was reportedly seeking to rally other countries to oppose the U.S. proposal and to isolate the United States.[48] As they prepared for the upcoming December negotiating session, the Europeans and Japanese lined up, almost without exception, in opposition to any large scale movement towards grants.[49] The Canadians were reportedly willing to consider steps that would increase the grant element of IDA lending (by lowering or waiving the service charge and extending the repayment period) while preserving the basic principle that IDA assistance must be repaid.

By the December negotiating session, in Montreux, Switzerland, the IDA deputies had reached agreement on all issues save the actual size and proportional distribution of the new replenishment and the share allocated for grants. The United States put on the table in Montreux a two part proposal[50]. "The U.S. is willing to *substantially* increase its individual contributions to the 13th replenishment of the International Development Association (IDA)," it said, "with agreement on two important issues." First, it stated, the United States wanted to see the adoption of a results-based contribution framework. Second, it wanted a substantial increase in the share of grants. "If the conditions were met, " Treasury said, "the full U.S. contribution would represent an 18% increase from IDA-12."[51]

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[47] World Bank. *IDA Eligibility, Terms and Graduation Policies.* International Development Association, January 2001. Prepared for the first IDA 13 negotiating session in Paris, February 28-March 1, 2001. Available from the World Bank web site at [http://www.worldbank.org/ida/ida13docs.html].

[48] Alan Beattie, "UK minister aims to halt proposal to replace loans; World Bank aid." *Financial Times*, London edition. (November 17, 2001c), p. 8.

[49] Alan Beattie, "Feeling the pressure: World Bank, by Alan Beattie; the bank has been beset by criticism of its direction and management style." *Financial Times*, Surveys edition. (November 30, 2001), p. 4. See also: *Jiji Press English News Service.* "U.S. Out of Step with Japan, Europe on IDA Capital Hike Talks." Tokyo (December 11, 2001), p. 1.

[50] U.S. Treasury Department.(2001a) Paper titled "U.S. IDA-13 Objectives." ND Presented to the IDA deputies negotiating session in Montreux, Switzerland, December 8, 2001. Photocopy provided by Treasury Department to author.

[51] The 18% increase in U.S. contributions is calculated in dollar terms. In terms of the SDR, the unit of account for IDA replenishments, Treasury officials said the U.S. increase would be closer to 25% because of recent movements in the relative value of the U.S. dollar (continued...)

The U.S. proposal was somewhat vague as to the nature of the results-based contribution framework it desired. Basically, it said that the U.S. would increase its contribution in phases contingent on "explicit input actions (such as country fiduciary, investment climate and poverty diagnostics necessary to design and evaluate credible lending programs) and development results in areas most crucial to growth and poverty reduction (such as school enrollment rates, people with clean water, sustained productivity growth, per capita incomes, and poverty rates.)" The United States invited other countries to explore ideas for trigger mechanisms along these lines. The Treasury official heading the U.S. delegation commendted later that, in practical terms, this probably would require some type of institutional changes in the Bank, since changes in world poverty levels or the success of IDA programs would not be measurable (even with maximum effort) in just two years.[52]

The negotiations were adjourned from Montreux with no settlement of the outstanding issues. The other donor countries were reluctant to go to, or much beyond, the 10% level while the United States held firm for the 50% goal. The other countries had no clear response to the U.S. proposal for adoption of a results-based contribution system. Many countries were concerned that the changes sought by the United States might alter the multilateral banks in ways that ultimately would hurt the poor. Many still had deep reservations about the long-term impact a large grant program might have on IDA finances. The IDA donor countries plan to meet in late February 2002 for another negotiating session, if they believe that sufficient grounds for agreement on a final plan have been developed. The issue is likely to be discussed at various levels during the series of G-7 meetings scheduled during late January and early February. Some participants in the discussions are reportedly pessimistic. Others believe that adequate grounds for agreement will be found. "There is a general consensus," said a close World Bank observer, "that there will be a consensus."[53] He also noted that, until the British and Americans can work something out, "it will be hard to get a resolution." Ultimately, he observed, "Everybody knows its going to end up somewhere in the middle, but they haven't gotten to that point yet."[54]

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[51](...continued)
compared to the currencies of other donor countries.

[52] Interview with Schuerch, January 10, 2002. He said this was not a plan to make disbursements for IDA assistance contingent on the recipient meeting specific performance benchmarks (as proposed by the Meltzer Commission or Meltzer and Lerrick.) Rather, Treasury had in mind additional improvements in IDA's new (since 1998) country policy and institutional assessment procedure. The latter seeks to target the bulk of IDA resources to countries that score highly on twenty performance criteria. This tries to ensure that most IDA money goes to countries deemed most likely to use it effectively. Reference was made by Schuerch to several papers (not available to the public) prepared by World Bank research staff and to information on the Bank's web page. For the latter, see World Bank. *How IDA Resources are Allocated.* Updated November 2000. Available from the Bank's web site at [http://www.worldbank.org/ida/idaalloc.htm].

[53] John Donaldson, senior official in the Bank's external affairs office, in Julian Borger, "Short Blocks US Plan for World Bank Grants," *The Guardian* [Manchester, UK]. January 17, 2002, p. 16.

[54] John Donaldson, in Paul Blustein, "U.S.-Europe Clash Stalls World Bank Aid Plan; Bush
(continued...)

As requested by its stockholders, the World Bank prepared another paper for the December session analyzing the potential financial and program impact of several different kinds of IDA grant programs.[55] These included grants linked to certain uses, 50% grants limited to countries with annual per capita income levels below $350, both of these options with easier terms for remaining IDA loans, and 50% grants for all IDA-eligible countries. Substantial differences in the financial impact on IDA were noted. However, in certain cases (grants limited to certain uses, softening the terms and perhaps waiving the service charge), the Bank was able to present figures showing that only 10% of total IDA resources would be needed while 50% of the projects or programs in the group could be made available on grant terms. For the categories reserving IDA grants for low-income, however, the share of total IDA resources devoted to grants was upwards of 20% and for the U.S.-preferred option the total was (for reasons explained above) about 40%.

The Bank later reported that the U.S.-preferred IDA-only grant program would have major out-year costs. During the first decade, it said, the cost to donors would be about $30 million annually. During the second decade, the average annual cost would be $570 million. In the third decade, if the donors want to maintain IDA at its existing level, another $1.8 billion annually in new contributions would be required. During the forth decade, to keep IDA the same size, the donors would need to contribute an additional $3.5 billion annually.[56]

Where To Go From Here

Critics hear in the proposal by President Bush echos of the plans put forth by Professor Meltzer and his colleagues. The conditional reimbursement plan mentioned in the President's original speech – no payment to the private supplier of services unless goals are achieved – is similar to that proposed in the Meltzer Commission. The President's call for more IDA aid for education, health, and poverty alleviation programs reminds many of the Commission's plan to scrap the World Bank's other loan priorities in favor of a special concentration on poverty alleviation and global public goods. Also, by not discussing publicly the long-term costs or U.S. additional contributions, the President seemed to suggest in his speech that a major IDA grant program could be instituted at little or no cost to the donor countries. The Treasury Department's later initiatives during the IDA negotiations, including the suggestion that the U.S. contribution might be increased by 18% and the Secretary's criticism of

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[54](...continued)
Seeks Grants, Not Loans for Poor," *The Washington Post.* January 16, 2002, p. E1.

[55] World Bank. "Grants and Concessionality in IDA13." International Development Association, November 2001. Prepared for the fourth IDA 13 negotiating session in Montreux, Switzerland, December 6-7, 2001. Available from the Bank web site at [http://www.worldbank.org/ida/ida13docs.html].

[56] [World Bank]. "Measuring the Costs of IDA Grants." ND. Unpublicized memorandum sent to IDA donor countries after the December meeting. The amounts are larger than those reported in the November 2001 paper on grants and concessionality. Provided to author by World Bank on February 6, 2002.

the Meltzer Commission plan, were not publicized or given much public emphasis. In any case, it was (and remains) unclear how the Department's negotiating position comports with the goals announced in the President's speech.

Concern on this score is compounded by statements by some supporters of the President's plan. For example, Schaefer says that "In all respects, the grant system proposed by the Meltzer Commission would be superior to the current World Bank lending system." He believes that President Bush has endorsed the Meltzer plan. In the next sentence, he says that "[t]he Bush Administration recognizes this fact," in the President's July 17 proposal. The President's plan is, he says, "a variation of the Meltzer Commission proposal."[57]

The Global Challenge Initiative (GCI), a long-time critic of the IMF and World Bank, picked up on this point. "Many of the opponents of the U.S. [grant] proposal see the U.S. as potentially destroying the World Bank and supplanting it with a small grant-giving agency that spearheads output-based aid schemes," it stated. It observed that this model had been proposed earlier by the Meltzer Commission. A grant program linked to output-based aid and a broad emphasis on privatization in the health, education, and clean water sectors would substantially reduce future access by poor people to public services and open the field to unregulated activity in these (and other) areas by foreign investors, GCI concluded.[58]

A World Bank official was quoted as telling the press in mid-2001 that the President's decision to put a specific number on his proposal for IDA grants was "distracting."[59] From this perspective, it raised many extraneous issues and made the negotiations on the issue more difficult when he announced a figure much larger than those the other countries had considered. Concern, on the part of other donors, about the size, implications, and possible hidden motives behind the President's seems widespread.

From another perspective, though, the President's bold announcement pushed the discussion into new areas which might not have been explored otherwise. John Taylor, the current Undersecretary of the Treasury, is quoted as saying that the one-half figure is not negotiable and the other donor countries need to come around to the U.S. position. "We will go all the way to Bush's proposal – I don't see it as a bargaining situation."[60]

This may be an effective strategy, as a final decision on the IDA replenishment must be reached in early 2002 so there will be time for national legislatures to act during the year. Many people believe the Administration is less desirous than are other donors of achieving a large replenishment. On the other hand, Taylor's firm language may be a negotiating ploy, some observers note, especially in the light of a

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[57] Schaefer, *op. cit.*, pp. 7-8.

[58] See GCI, "Growing Dangers of Service Apartheid," *op. cit.*

[59] John Donaldson, quoted in Anna Willard, "USA to Stand Firm on World Bank Grant Proposal." *Reuters*. (August 6, 2001.)

[60] John Taylor, quoted by Willard, *op. cit.*

parallel U.S. campaign to win broad multilateral support in its efforts to combat international terrorism.

There would appear to be grounds for compromise on this issue. In money terms, the two sides seem far apart. In other ways, however, the difference between the parties may be smaller. IDA lent about $2.13 billion for health, education, social protection, and water and sanitation projects, about 32% of the total. Likewise, IDA lent $2.87 billion in 2001 to countries with per capita income levels below $350 annually. This comprised about 41% of the total. If half that assistance had been provided on a grant basis, either 15% or 20% of IDA resources would have been required. Either approach could be the basis for a split-the-difference type compromise.

There might be room for a functional compromise. In addition to a modest grant program, the replenishment might provide that a major share of IDA's loans to very poor countries would be repayable in local currency. This would retain the principal that loans must be repaid and – with a maintenance of value provision – the value of the repayments would be retained. The local currency could be used for loans to the issuing country covering local cost financing, recurring costs, or other similar activities. In effect, though loans, these repayments would not require that countries find foreign exchange to cover the cost of projects whose economic benefits will not be realized until many years in the future.

Likewise, there might be room for a procedural compromise which allows everyone to do what they want. Instead of the IDA 13th replenishment being a single account, the donors could establish two sub-accounts, with contributions to either being counted as contributions to the replenishment as a whole. The funds contributed to IDA 13A would be used to fund loans, as in the past. Those contributed to IDA 13B would be used to fund grants. If the other donors channeled 10% of their overall contribution to the grant account and the United States contributed its entire share, the amount available for grants would comprise 28% to 31% of the total replenishment (depending on the final U.S. share.) The grant component would be even larger if other countries contributed a larger share or if the World Bank put the entire amount it usually contributes (from IBRD net income) into the grant account. The latter might be done on the understanding that funds would be used for projects fighting AIDS and other endemic diseases, for assistance to the poorest, and for programs addressing global public goods. All have been priority concerns of the Bank and IDA in recent years.

There might even be room for a hybrid compromise. Half the IDA's loans to poor countries might be made on a conditional basis, where the repayments are automatically waived each year (as a contractual right) so long as the borrower meets certain specified criteria. For instance, no repayment would be required if the recipient continued to meet the education, health, poverty reduction or other performance requirements in the original loan plan. This would de facto convert future loan repayments into future grants and establish a 40 year incentive plan for recipient countries.

From the U.S. perspective, it appears that the Administration may need an agreement where 50% of some type of IDA assistance will be allocated as grants.

Otherwise, the new IDA 13 replenishment bill may face renewed criticism in Congress as well as opposition by the Administration's conservative supporters. By contrast, with a 50% agreement of some type, the Administration might be able to present the replenishment plan as a victory and a demonstration that the World Bank can be "reformed." This would be particularly so if the new replenishment required broadly-supported institutional changes or the adoption of improved methods for monitoring project implementation and outcomes.

From the perspective of the other donor countries, by contrast, it would appear important that any agreement for IDA grants should not threaten the financial integrity of the program. One possibility might be an IDA 13 replenishment plan in which a larger share of the new resources comes from donor contributions and a smaller share comes from the advanced commitment of future reflows. More reflows could be scheduled for use in financing new loan commitments only when they were actually received. This would leave available for future IDA replenishments a larger share of the remaining future reflows. On this basis, any long-term negative effects that a grant program might have on IDA finances would be limited in their impact and would be spread out over a longer period of time.

Several other observations might be made. First, it is not clear how much grant money the poor countries could afford to receive, particularly if the assistance requires increased spending for social sector programs. Grants will relieve countries of the need to budget for repayments. However, they can add to countries' budgetary costs in other ways. The MDBs usually finance the import costs of projects. The borrower normally pays the local costs as well as the recurring costs for programs or projects once they are established. The recipients would have to find room in their national budgets – often a difficult task – for these costs. Health and education programs generally require larger proportional inputs from the recipients than do many other kinds of projects. If the recipients cannot afford the counterpart and recurring costs of new health and education programs, it may be inappropriate for IDA to set aside large sums for grants to sponsor them.

Second, concern about the long-term implications of the Bank's prospective private sector development strategy need not be an impediment to adoption of a grant program. President Bush said, in his original speech, that performance based assistance should be part of his proposed grant program. However, it is not evident from his speech and subsequent Administration statements that all IDA grants need be provided on this basis. If the parties were willing, the new replenishment agreement could provide that none or only a small portion (perhaps up to 10%) of IDA grants could be used in this manner.

Third, the growth effects of different types of programs may merit consideration. Treasury Secretary O'Neill said earlier in 2001 that he believed the MDBs should put less emphasis on peripheral matters and more stress on programs that encourage economic growth and increased productivity. Investments in human capital (through education, health, and related programs) will improve the productivity of labor in the long run. However, investments in infrastructure (power, transportation, etc.) and capital facilities may boost efficiency levels and promote growth and development somewhat faster. Likewise, programs promoting economic policy reform, better governance, stronger institutions, and recovery from war or natural disaster can have strong medium-term growth effects. Also, improvements in infrastructure and reform are more likely to stimulate inflows of foreign investment. Unless the donors expand the size of the IDA program, more IDA assistance for humanitarian programs will necessarily mean less assistance for other types of programs.

Fourth, steps may be required to protect U.N. grant programs from competition from an IDA grant program. The terms and objectives of an IDA grant program will need to be coordinated with those of the U.N. Development Programme, World Food Program, and other international grant-making programs. Some critics of the President's proposal worry about "mission creep,"a concern that IDA might compete or undercut the other U.N. agencies if it has a sizable grant program. However, there is a great deal of overlap and similarity among the multilateral banks and the U.N. development agencies these days in the types of programs they all finance. The World Bank may have made incursions into the other agencies "turf," but there seem to have been at least as many incursions in the other direction as well. Supporters of the existing arrangement argue that an IDA loan program is desirable, if only because it teaches borrower countries that the repayment of debt has positive consequences. However, questions have been raised as to whether the principal difference between IDA and the U.N. development programs should be their repayment terms and not in the types of activities they support or the skills and priorities they bring to the table. IDA loans or IDA grants, the issue of overlap among the international aid agencies is one which merits closer examination.

Fifth, attention might also be paid to the equity effects of future changes in IDA's repayment formula. The World Bank has suggested, for example, that IDA might "harden" some of its repayment terms in order to offset the costs of a grant program. Caution should be exercised regarding plans for "gearing up" the creditworthiness of borrower countries or for promoting "efficiency" in IDA operations. In themselves, these may be worthy concerns. Countries may enhance their creditworthiness if they are able to pay a gradually increasing interest rate for their IDA loans. The efficient use of IDA resources may also be improved if less needy countries pay more for IDA loans. However, if the proceeds of the higher IDA interest costs are used to defray the costs of IDA grants, then some of the cost of the grant program will have been shifted from the rich donor countries to the poor countries who are only slightly better off than their poorer neighbors.

Sixth, the claim that recipient countries will be more likely to waste IDA resources if they receive assistance in the form of grants rather than loans might be questioned. This argument seems to presume that the Bank's normal oversight mechanisms would break down or the Bank would be more willing to fund weak projects through grants than it would through loans. There is no evident reason why the Bank would use different standards for evaluating or implementing grant projects than it would for loan projects. Likewise, there is no way of knowing beforehand whether the Bank will make better use of IDA resources if it gets them back as loan repayments than the recipient will do if it had them as a grant. Nobody knows whether the governments of IDA-recipient countries will be wise or foolish thirty years from now. An appropriate concern might be whether the poor in those countries are the principal beneficiary of the activities funded by the hypothetical loan repayments. In any case, future country performance issues can be addressed at least as easily through the Bank's country review process as through future loan programs.

Seventh, it seems apparent to most observers that little real progress can be made in a discussion about IDA grants if other participants harbor serious reservations about the long-term motivations of the United States. From press reports and discussions, it seems that some countries worry that the President's grant proposal would "defund" IDA, substantially increasing the future cost of the program and possibly leading to its closure or substantial reduction in size. Few people seem to know about the Administration's statement in December 2001 that it might support an 18% increase in U.S. contributions. Progress in the negotiations might be enhanced if all donors were willing to discuss and include language in the final report describing their long-term plans and expectations. In particular, they might state whether they believe their countries' future contribution levels to IDA should increase (as a decline in future reflows diminishes the amounts of money IDA has available to support new loans) or whether they believe the IDA program should shrink in size as the inflow of future debt repayments gradually declines.

In many respects, it appears that the controversy about IDA loans and grants is not really one about IDA finances. The costs and benefits of a grant program would be phased in gradually and would become significant only thirty to forty years hence. The real benefits from a grant accrue, not at the time of the award, but at the time the repayments for the alternative loan would need to have been made. In fact, IDA could reduce its assistance levels to former grant recipients by amounts comparable to the hypothetical loan repayments and countries would have the same amount available in future years to fund new development projects as they would have if all assistance had been financed through loans. Whether or not they would use it wisely and for anti-poverty purposes is a different concern.

The World Bank reports that a grant program would require billions of dollars in new annual contributions from donors thirty or forty years hence if IDA is to be kept at the same level as before. This presumes that the donor countries continue to include a 50% grant provision in future replenishments. It also assumes that the demand for development aid will be as great forty years from now as it is today and the World Bank will need those IDA reflows in 2040 to fund new IDA loan programs whose repayments would stretch to the end of the century and fund new loans going well into the next. All these contingencies are speculative. If they were agreed on basic principles, the donor countries and the Bank should be able to work them out over the coming decades.

On another level the controversy seems to be, not IDA finances, but the donor countries' relative influence in international agencies. Until recently, the United States has been the predominant voice and influence within the World Bank. Increasingly, however, it seems that the other donor countries are becoming more assertive in their views. In part, this may be due to concern about the direction of U.S. policy. In part, though, it also seems a function of their growing relative size. Already, it appears that the European countries are devising their policies more in consultation with one another than in separate consultations with the United States. Should the countries of the European Union ever develop a common policy position, they would be in effect the largest single "member country" in the Bank. The debate on IDA grants seems to presage a situation where influence in the multilateral banks will be more evenly distributed and where – unless the United States makes major efforts to increase its financial support and to reshape the way it tries to influence policy – the

Europeans in particular will seek and find a larger role. What effect this may have on the organization and operations of the multilateral agencies remains undetermined.